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* The document is late submitted because it reports on the Working Group's session which was held between 13 and 17 May 2002

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I. Introduction

1. The Commission, at its thirty-second session (1999), had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that have expertise and interest in the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission for the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country had adopted had become a "front-line" factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work on an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session.

4. At its thirty-third session in 2000 the Commission noted the recommendation that the Working Group had made in the report of the exploratory session held in Vienna from 6 to 17 December 1999 (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), INSOL International (INSOL) (an international federation of insolvency professionals) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the Secretariat, in cooperation

with INSOL and the IBA organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna, from 4-6 December 2000.

6. At its thirty-fourth session in 2001, the Commission had before it the report of the Colloquium (A/CN.9/495).

7. The Commission took note of the report with satisfaction and commended the work accomplished so far, in particular the holding of the Global Insolvency Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.

8. The Working Group on Insolvency Law commenced the preparation of a legislative guide to insolvency law at its twenty-fourth session (New York, 23 July to 3 August 2001) and continued its work at its twenty-fifth session (Vienna, 3-14 December 2001). The reports of those meetings are contained in documents A/CN.9/504 and A/CN.9/507.

9. The Working Group on Insolvency Law, which was composed of all States members of the Commission, held its twenty-sixth session in New York from 13 to 17 May 2002. The session was attended by representatives of the following States members of the Working Group: Austria, Brazil, Burkina Faso, Canada, China, Colombia, Fiji, France, Germany, India, Iran (Islamic Republic of), Italy, Mexico, Russian Federation, Singapore, Spain, Sudan, Sweden, Thailand and United States of America.

10. The session was attended by observers from the following States: Algeria, Australia, Denmark, Gabon, Iraq, Ireland, Jordan, Malta, New Zealand, Nigeria, Philippines, Portugal, Republic of Korea and Switzerland.

11. The session was also attended by observers from the following international organizations: (a) organizations of the United Nations system: International Labour Organization (ILO), International Monetary Fund (IMF), World Bank; (b) intergovernmental organizations: League of Arab States, European Bank for Reconstruction and Development (EBRD), (c) non-governmental organizations invited by the Commission: American Bar Association (ABA), American Bar Foundation (ABF), Groupe de reflexion sur l'insolvabilité et sa prévention (G.R.I.P.), International Bar Association (IBA), International Federation of Insolvency Professionals (INSOL), International Insolvency Institute, International Law Institute, International Working Group on European Insolvency Law.

12. The Working Group elected the following officers:

Chairman: Mr. Wisit WISITSORA-AT (Thailand);

Rapporteur: Mr. Jorge PINZON-SANCHEZ (Colombia).

13. The Working Group had before it three Notes by the Secretariat: Draft legislative guide on insolvency law A/CN.9/WG.V/WP.61 and Addenda 1 and 2.

14. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a legislative guide on insolvency law.
4. Other business.
5. Adoption of the report.

II. Deliberations and decisions

15. At the present session, the Working Group on Insolvency Law continued its work on the preparation of a legislative guide on insolvency law, pursuant to the decisions taken by the Commission at its thirty-third (New York, 12 June-7 July 2000)[1] and thirty-fourth sessions (Vienna, 25 June-13 July 2001)[2] and of the Working Group on Insolvency Law at its twenty-fourth and twenty-fifth sessions. The decisions and deliberations of the Working Group with respect to that legislative guide are set forth below.

16. The Secretariat was requested to prepare a revised version of the Guide, based on those deliberations and decisions, to be presented to the twenty-seventh session of the Working Group on Insolvency Law (Vienna, 9-13 December 2002) for review and further discussion.

III. Preparation of a draft legislative guide on insolvency law

A. General Remarks

17. The Working Group suggested that the reorganization procedure needed to be discussed more clearly in the recommendations and that reorganization should be stressed before liquidation. It was also suggested that sections C and D of chapter V should be moved from the chapter on administration of the insolvency proceedings to a subsequent part dealing with resolution of the proceedings. A further suggestion was that the recommendations should be included in the draft Guide both as a

[1] *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17*, A/55/17, paras. 186-192.

[2] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 18*, A/55/18, paras. 296-308.

separate text or annex, as well as throughout the document following each relevant section of the analytical commentary.

B. Part One. Key objectives

18. As a general remark, it was observed that the recommendations focussed upon the protection of creditors and did not mention the protection of the debtor, which was an equally important aspect of an insolvency regime.

19. As to the form of Part One, support was expressed in favour of including the recommendations in the form of a preamble to state the purposes and objectives of the Guide. That approach would establish the background for the recommendations that would follow the preamble and would also serve as a useful tool of interpretation.

20. A number of suggestions were made as to the content of recommendations (1) to (7). It was suggested that recommendation (1) should focus more clearly on the options of liquidation and reorganization and omit the words following "businesses" in the second line. A proposal to include a reference to the need to give full consideration to the protection of employees in recommendation (1) was not supported.

21. The Working Group generally agreed that recommendation (3) should include the term "equally" rather than "equitably" with respect to similarly situated creditors, while the term "equitably" was more relevant in the context of recommendation (6) and the treatment of different classes of creditors and that that usage should be reflected throughout the draft Guide.

22. General support was expressed in favour of including in recommendation (5) a reference to the periodic provision to creditors by those supervising the insolvency process of information with respect to the debtor's financial situation and the progress of the proceedings.

23. In the context of recommendation (6), it was noted that the protection of employees was of particular importance in an insolvency law and that they should be specifically mentioned as a class of creditor requiring particular attention. While that proposal received some support, the Working Group was generally of the view that although protection of employees was an issue of some importance (particularly in terms of meeting international obligations) a reference to one particular class of creditors in recommendation (5) was not desirable and might reflect a policy bias that should not be included in the general objectives. It was observed that as drafted the reference to creditors would include employees with claims and that the issue of protection of employees could be addressed more specifically under the sections on treatment of contracts and distribution.

24. General support was expressed in favour of retaining recommendation (7) to encourage and promote adoption of the Model Law on Cross-Border Insolvency.

25. Suggestions for additional recommendations were that all claims of creditors should be dealt with in a single insolvency proceeding, and that the insolvency law should encourage the search for an amicable agreement and solution to the debtor's financial situation to avoid the need for insolvency proceedings.

C. Part Two. Core provisions

1. Introduction

A. Structure [organization] of the insolvency regime

26. It was suggested in respect of recommendation (8) that more explanation should be included in the Guide and recommendations on the ways in which the different procedures could be arranged in the insolvency regime.

27. A drafting suggestion was that the reference to the ability of the debtor to convert proceedings in recommendation (9) should be amended to refer to the need to include in the insolvency law a facility for conversion of proceedings.

2. Application for and commencement of insolvency proceedings

A. Eligibility and jurisdiction

28. A general remark was that the draft Guide should more clearly indicate whether each recommendation applied to either liquidation and reorganization or to both procedures.

29. It was observed that recommendation (13) was potentially in conflict with article 28 of the Model Law on Cross-Border Insolvency which provided for commencement of insolvency proceedings on the basis of presence of assets. In response, it was suggested that a distinction should be drawn between the draft Guide and the Model Law on the ground that the Model Law referred to commencement of ancillary proceedings based on presence of assets in a situation where main proceedings had been commenced elsewhere, whereas recommendation (13) was referring essentially to commencement of those main proceedings. It was noted however, that since some insolvency laws did provide for commencement on the basis of assets, a more flexible approach should perhaps be adopted in the draft Guide. It was suggested that the recommendations should include a general statement of the principle along the lines of paragraph (c) of the purpose clause, that is that the insolvency law should address the question of which debtors have sufficient connection to a State to be subject to its insolvency laws. An additional recommendation should then be added to the effect that while different approaches might be taken to identifying those connecting factors, as a minimum or as examples, they should include those set forth in recommendation (13) paragraphs (a) and (b).

B. Application and commencement criteria

30. General support was expressed in favour of amending the reference in paragraph (c) of the purpose clause from "inexpensive" to "cost effective".

31. Concern was expressed with the reference in recommendation (17)(a) to the future inability of the debtor to pay its debts, on the basis of the difficulty of proof of that criterion and the need to establish some element of the imminence of that inability. It was suggested that if the inability to pay was not imminent, the debtor should seek to resolve its position by informal negotiations, not by commencing formal proceedings. It was observed in response that informal negotiations were not

always possible with respect to certain types of financial instruments which required unanimity for amendment of repayment terms.

32. A contrary view was that the recommendation should be included as currently drafted in order to encourage voluntary applications by debtors at an early stage, which the Working Group had agreed should be a key element of the insolvency law. It was suggested in support of that view that if such a provision led to abuse by debtors, that issue should be addressed in terms of the consequences of the application, rather than in terms of the commencement criteria.

33. Concern was also expressed with regard to recommendation (18) on the basis that failure to pay a single debt might lead to application of the presumption without consideration of whether the debt was disputed or whether there might a right of set-off in respect of that debt. To address those concerns it was suggested that the recommendation should include words to the effect that the debt was not subject to a legitimate dispute or an offset in an amount equal or greater than the amount of the debt. That proposal received some support. With respect to the number of creditors, some support was expressed in favour of requiring failure to pay more than one creditor. In response, it was suggested that what was important was not the number but rather the quantity of the debt held by a particular creditor and the relationship between assets and liabilities. It was noted, however, that different approaches with respect to those issues might need to be taken in different countries to reflect varying stages of economic development, prevalence of different types of financial instruments and other similar factors.

34. A further concern was that as presently drafted, recommendation (18) did not make it clear how the debtor could defend itself against such a presumption. In response it was suggested that recommendations (20)(b) and (23) provided protection for the debtor who would have the opportunity to rebut the presumption by showing that it was able to pay its debts, that the debt was subject to a legitimate dispute, that the debt was not mature and other relevant facts and the court would have to assess those facts in considering whether or not to commence insolvency proceedings. It was observed that the purpose of the recommendation was to provide an opportunity to compel the debtor to show that it should not be subject to the insolvency law.

35. After discussion, the Working Group agreed that in order to accommodate the different views expressed, the recommendation should indicate that the insolvency law "might" rather than "should" provide for the inclusion of a presumption, with reference to the different approaches that might be taken with respect to the circumstances that must be established for proceedings to be commenced, in particular the number of creditors or quantity of debt that might be required.

36. Support was expressed in favour of retaining in recommendation (21) the words in square brackets as examples of how notice might be provided and adding references to other means by which notice could be given, such as through relevant electronic registries. Another suggestion which received support was that recommendation (21) should be limited to provision of notice to the public and that recommendation (22) should address provision of notice to creditors, both known and generally. A further suggestion which received support was that the information to be included in the notice to creditors should be set forth in a separate

recommendation which would apply to both the general notification of creditors and notification to known creditors and should be a requirement of the law.

37. With regard to the opening words of recommendation (23), it was suggested that a distinction should be drawn between denial of an application for commencement and dismissal of proceedings, especially where the commencement criteria functioned as automatic commencement, as referred to for example in recommendation (19)(a). General support was expressed in favour of including two recommendations to deal with denial along the lines of recommendation (23) and a separate recommendation providing for dismissal on the grounds contained in (23)(a) and (b). A proposal that a further ground should be added to reflect the discussion in the Working Group on denial of an application based upon the debt being the subject of a legitimate or bona fide dispute was supported. The Working Group agreed that the text in the second set of square brackets in paragraph (b) was preferable and should be retained, and that a subheading could usefully be added to the recommendation.

3. Treatment of assets on commencement of proceedings

A. Assets to be affected

38. One suggestion of a general nature in respect of the recommendations on assets to be affected by the commencement of insolvency proceedings was that a distinction should be drawn between liquidation and reorganization, as the assets to be affected by the commencement of different types of proceedings may differ. In response, it was observed that that approach might establish an artificial distinction which could potentially be abused by debtors. It was also noted that the difference between liquidation and reorganization was more important in terms of how the assets were affected, rather in the definition of the assets to be included in the estate.

39. With respect to recommendation (24)(a), the Working Group discussed the question of the location of the assets to be subject to the proceedings and whether the recommendation should adopt the universal approach of referring to all assets "wherever situated". Some concern was expressed in relation to both that approach and to the Guide addressing the question of which law should govern the assets, particularly secured assets.

40. After discussion, the Working Group agreed that the concerns expressed could be accommodated by revising the recommendation along the lines "The insolvency law should define the assets to be included in the insolvency estate" which might include assets of the kind referred to paragraphs (a) and (b) of recommendation (24) and clearly indicating whether the law adopted a universal or territorial approach to the assets to be included. Support was also expressed in favour of the proposal that the Guide should clarify how assets possessed by the debtor pursuant to a contract should be treated and include a reference to assets recovered through avoidance actions and potential assets, such as prospective awards from an action for damages.

B. Protection and preservation of the insolvency estate

41. With respect to recommendation (26)(a) some concern was expressed as to the meaning of the word "execution" and it was suggested that the paragraph should

refer to "execution and other enforcement against the assets of the insolvency estate" to clarify the point. It was also suggested that that language could be used in recommendation (28)(b). It was pointed out that recommendation (26)(b) should refer to administration "or" realization of all or part of the debtor's assets, although the need to address realization was questioned. With respect to the words following "...preserve the value of assets" an alternative was suggested along the lines of "in accordance with the objective of the insolvency proceedings" which would accommodate both liquidation and reorganization without specifying the types of actions included in (26)(b).

42. A further concern raised was whether the recommendations as presently drafted would apply to secured creditors. To address that issue it was suggested that the words "including perfection or enforcement of security interests" could be added to recommendation (28)(a). A further suggestion to clarify that point drew attention to the difference between the language of recommendation (28)(c) and article 20 of the Model Law on Cross-Border Insolvency on which the recommendation was based. To clarify the concern, it was suggested that the language of (28)(c) should be amended to "the transfer, encumbrance of other disposal of any assets of the insolvency estate is suspended." In the course of the discussion of recommendation (28)(a) it was observed that in some countries the stay and suspension did not apply to commencement or continuation of actions, but rather to enforcement of the outcome of those actions. It was noted that that approach was reflected in article 20(3) of the Model Law on Cross-Border Insolvency.

43. With regard to recommendation (32) it was suggested that both texts in square brackets in paragraph (a) should be retained.

44. A suggestion was made that recommendation (33) should be redrafted to express the general principle of protection, with the types of protection mentioned in the recommendation to be included as examples of how that protection might be provided.

C. Use and disposition of assets

45. As a matter of drafting, support was expressed in favour of the proposal to omit from paragraph (c) of the purpose clause the references to abandonment or surrender of assets and refer only to treatment of burdensome assets and, using the language of recommendation (38), assets determined to be of no value to the insolvency estate and assets that cannot be realised in a reasonable period of time.

46. A general concern raised related to the definition of "insolvency representative", and whether it would include a debtor in possession. It was noted that that issue could be considered at a later time when the Working Group considered the glossary to the draft Guide.

47. Concern was expressed that the relationship of recommendation (35) to recommendation (24) was not clear and, in particular, whether assets owned by third parties would be considered part of the insolvency estate.

48. With respect to recommendation (36) it was proposed that both texts in square brackets should be retained so that the assets should be both of benefit to, and necessary for, the conduct of the insolvency proceedings. A concern was expressed as to the meaning of "assets subject to security interests" and whether the

reference was limited in the context of recommendation (36) to rights *in rem*. It was observed that the draft recommendations included provisions addressing the protection of secured creditors (recommendations (32) and (33)) and counterparties to contracts with the debtor (recommendation (44)). To ensure the protection of third parties, it was proposed that parallel provisions be included after recommendation (36).

49. Some support was expressed in favour of a proposal that the second sentence of recommendation (39) should require private sales to be subject to supervision by the court or approval of the creditors. In regard to approval of creditors, it was suggested that reference should be made to the section on creditors and the creditor committee. In response to a suggestion that the recommendation should perhaps make a distinction between sales in liquidation and reorganization, it was noted that the purpose of the provision was to address the issue of sales outside the ordinary course of business, whether in liquidation or reorganization. In response to a question of whether or not a creditor could be a buyer, it was noted that it was not generally desirable to place restrictions on who could purchase assets of the debtor, and that what was required were protections of the kind included in recommendation (39). It was further proposed that those protections would also be relevant to recommendation (40).

D. Treatment of contracts

50. As a matter of drafting, concern was expressed as to the precise meaning of the phrase "that have not or not fully been performed by either the debtor and its counterparty" and thus to the scope of section D. It was clarified in response that the section was intended to address contracts that required performance by both parties and not simply the situation where one party had performed its obligations and was awaiting payment by the other party. The Secretariat was requested to reflect that idea more clearly in the draft recommendations.

51. Support was expressed in favour of using mandatory language in recommendation (42) and including as a further category (c) the fact of insolvency of the debtor or its weakened financial position. Recalling the discussion in the context of protection of the estate that many countries provided for the stay to apply to the counterparty to a contract with the debtor in order to prevent the contract being terminated, support was also expressed in favour of ensuring that that was clearly stated in the recommendations to ensure that the contract remained in place to allow the insolvency representative time to consider the possibility of continuation.

52. With respect to recommendations (43) and (45) it was noted that (43) contained a condition for continuation whereas (45) made the right of rejection unconditional. It was proposed that (45) should be limited to contracts that were burdensome to the insolvency estate.

53. Wide concern was expressed on the inclusion of recommendation (46)(b) on the basis that it appeared to give an advantage to parties who did not perform their contractual obligations and had the potential to place an insolvent debtor in a stronger position than a party that continued to perform its obligations. In response, it was observed that paragraph (b) may have some application in certain cases, particularly in the case of reorganization, where the contract in question may be

crucial. After discussion, the Working Group agreed that the issue required further consideration and placed paragraph (b) in square brackets.

54. In the context of recommendation (50), it was noted that although reference was made to the time period within which the insolvency representative should act to continue or reject a contract, no provision was included for the counterparty to request the insolvency representative to take prompt action. That proposal was supported.

55. Different views were expressed as to the need for provisions on assignment of contracts. One view expressed was that the question of assignment should be left to the general law of contract and should not be addressed in the insolvency law. A contrary view was that special rules were required to address assignment in the insolvency context, particularly in those jurisdictions where assignment was not permitted against the disagreement of the counterparty. It was noted that a policy justification for such provisions was the retention of the value of a contract for the benefit of the insolvency estate (and subsequently creditors), provided that the counterparty's position was not disadvantaged or its position made worse as a result of the assignment. For those purposes, either Variant A or B was acceptable. A further view was that Variant A, recommendation (53) might be too difficult to satisfy and that all that was required were recommendations (51) and (52) of Variant A. After discussion, the Working Group agreed that the recommendations should reflect both views that assignment could be left to general contract law and that special provisions could be included in the insolvency law. The Secretariat was requested to prepare the necessary revisions.

56. As to recommendation (54), it was suggested that specific mention should be made of financial transactions (addressed in detail in section F), as well as contracts involving intellectual property where it was desirable that the contract be able to be continued.

E. Avoidance actions

57. With respect to the Purpose clause, it was suggested that paragraph (a) should not so much refer to preservation of the assets, as to reconstruction or reconstitution of the assets. The use of the phrase "fair treatment" was queried in light of the earlier discussion on the key objectives and the use of equal and equitable treatment. Suggestions for additions to the purpose clause included a paragraph to the effect that a purpose of the provisions was to ensure legal certainty for third parties as to the actions that might be avoidable, and a paragraph concerning the treatment of payments made prior to commencement that were in the ordinary course of business. Different views were expressed on the need to address post-commencement transactions in the section on avoidance, but the Working Group agreed generally that the issue should be addressed in the Guide, such as in recommendations (35) and (57)(d) or in the section on treatment of contracts.

58. A change to the title of the section to "Avoidance proceedings" was also proposed.

59. It was observed with respect to paragraph (b) that the phrase "involving the debtor" might be too narrow, as there may be transactions involving the debtor's property to which the debtor was not a party.

60. A drafting suggestion in respect of recommendation (56) was to replace "retrospectively" with "retroactively".

61. A number of views were expressed on recommendation (57). A preliminary remark was that the reference to "commence proceedings" in the chapeau might not be sufficient to cover other ways in which avoidance might arise, such as by way of defence to an action concerning particular assets brought by someone other than the insolvency representative. Additional suggestions were that paragraph (a) should refer, in addition to the transfer of assets, to the incurring of liabilities, and to transactions which left the debtor with few assets or in financial difficulties.

62. One concern with respect to paragraph (a) was that the reference to fraud might not be sufficient to describe the types of transactions that should be covered in the recommendation, and that what was required were examples of transactions and some objective indicators as to the types of transactions covered. A related concern was that the requirement of actual intent might prove difficult to satisfy and that a reference to situations where the third party had reason to suspect the fraudulent nature of the transaction might be of assistance. It was also suggested that the requirement of fraud might be too narrow and too specific and it was proposed that supplementary requirements such as transactions made in bad faith might be relevant. Another suggestion was that the word fraud be deleted and the section focus on the objective characteristics of the transactions sought to be avoided.

63. In respect of recommendation (61), it was proposed that it include the transactions referred to in recommendation (57)(a).

64. With respect to determination of the suspect period in recommendation (58), it was suggested that reference should be made to (62) and the need to have longer periods for the transactions addressed in recommendation (57)(a) generally, not just those involving related parties.

65. Support was expressed for the view that recommendation (65) was not required in the section on avoidance.

66. With respect to footnote 15, it was noted that the notion of control of the debtor and a reference to a legal entity, not just natural persons, should also be included.

67. It was suggested that a reference to the exercise of avoidance powers could usefully be added to recommendation (78).

68. It was observed that section E did not address the treatment in the insolvency proceedings of a transferee to a contract that was avoided where the transferee failed to disgorge or return the assets to the estate. It was noted that some insolvency laws provided that a claim by such a transferee would not be admitted.

F. Netting and set-off and G. Financial contracts

69. The Working Group based its consideration of those topics on the following text which had been revised by the Secretariat.

"F. **Netting and set-off** [A/CN.9/WG.V/WP.58, paras. 116-123]

(66) In general, netting and close-out arrangements should be legally protected and should, to the greatest extent possible, not be [unwound] [undone].

(a) A right of set-off existing under general law and exercised before the commencement of insolvency proceedings should be excluded from the application of provisions on avoidance;
(b) After commencement of insolvency proceedings, the insolvency law should permit creditors and the insolvency estate to exercise a right of set-off permitted under general law and should exclude the exercise of that right of set-off from the application of provisions on stay and suspension of actions against the debtor and treatment of contracts.

"G. **Financial contracts***

(67) Notwithstanding other provisions of general law or the insolvency law:

(a) upon application for commencement of an insolvency proceeding against a debtor, any creditor of the debtor that is a party to a financial contract involving the debtor may terminate that contract;
(b) upon an application for commencement of insolvency proceedings against a debtor, any creditor of the debtor that is a party to a financial contract involving the debtor may [apply security][exercise their security] and exercise rights of setoff under that financial contract; and
(c) transactions under a financial contract and related security arrangements should not be subject to provisions on stay and suspension of action against the debtor and should not be subject to avoidance provisions unless they constitute actual fraud.

"* The definition from the United Nations Convention on Assignment of Receivables in International Trade, 2001, Art. 5(k) provides: "Financial contract" means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above entered into in financial markets, irrespective of whether or not they were effected on an exchange, and any combination of the transactions mentioned above [*underlining indicates new text*]."

70. There was general agreement in the Working Group that those issues should be addressed in the Guide and that the Guide should stress the importance of the types of contracts to be covered and the complexity of the arrangements involved.

71. As to the scope of the financial contracts to be covered, it was suggested that the definition in footnote 16 was too broad and should be more narrowly focussed to cover only those transactions which formed part of a broader framework contract.

72. Some concern was expressed as to whether the right of set-off described was limited in its application to financial contracts or was of more general application. After discussion, the Working Group agreed that set-off in the context of those

recommendations would be limited to financial contracts and that the Guide would address the issue of set-off more generally in another section. It was proposed that the recommendation should, in the context of financial contracts, generally protect a pre-commencement right of set-off and permit post-commencement set-off where the mutual claims arose under the same framework agreement.

73. With respect to recommendation (67) it was noted that there was a need for an exception for financial framework agreements only where two conditions were satisfied: (a) where post-commencement set-off was not permitted for mutual financial obligations; or (2) where the insolvency law gave the insolvency representative the ability to override contract termination provisions.

74. It was suggested that the provisions required careful consideration to ensure that they were clearly explained and that countries would not adopt provisions that would interfere with the operation of arrangements such as SWIFT and the IATA clearing house, taking into account special systems rules on insolvency and unwinding of transactions.

4. Participants and institutions

A. The debtor

75. With respect to paragraph (a) of the purpose clause, it was noted that the text in square brackets referred to the obligations of third parties. Considerable support was expressed in favour of addressing the obligations of third parties in the draft Guide. While those obligations might include an obligation to deliver books and records belonging to or relating to the debtor and to surrender property of the debtor in the possession of the third party, it was noted that the obligations of third parties might differ from the corresponding obligations of the debtor. For example, it was suggested that the provision of information might need to be more specifically defined by reference to its relevance to the proceedings.

76. It was observed that given the importance of participation of the debtor in reorganization proceedings, "may" should be replaced by "should" in recommendation (70). That proposal was supported. It was also proposed that some distinction may need to be made between liquidation and reorganization, as the latter procedure required a more active participation, and the provision of information was more important to the success of the procedure.

77. With respect to recommendation (71), support was expressed in favour of adding a number of additional obligations. Those included an obligation of the debtor not to leave its habitual residence; to provide information on any ongoing court or administrative proceedings, including enforcement proceedings; to surrender property and business records; and to provide information on transactions occurring during the suspect period. With respect to the surrender of property, it was suggested that that obligation would need to be cross-referenced to recommendation (24) and limited to property that comprised the insolvency estate, whether domestic or foreign. With respect to foreign property, the suggestion was made that a reference to the Model Law on Cross-Border Insolvency and the appointment of a foreign representative might be appropriate. Both of those proposals were supported. It was also suggested that some consideration should be given to the

relationship between recommendations (71) and (73) and to indicating where the different obligations would be relevant to the types of procedures included in (73).

78. Wide support was expressed in favour of including an additional recommendation that made reference to recommendation (25) and the debtor's right to retain personal property needed for daily survival.

79. The Working Group agreed that the duty of confidentiality in recommendation (72) should extend to information in the control of the debtor but belonging to a third party and to information relating to trade secrets irrespective of whether that information belonged to the debtor or a third party.

80. Some support was expressed in favour of deleting recommendation (73)(c) on the basis that it described a particularly specialised type of procedure which relied on a well-developed court structure. The view was expressed that it was not an option that should be recommended without considerable explanation and background information. In response, however, it was agreed that since recommendation (73) merely set forth different options, all three paragraphs should be retained. It was noted, however, that some reference might be made to different levels of supervision that could be provided in such an approach, and to the protections that operated in conjunction with that approach.

81. Support was expressed in favour of retaining recommendation (74) and for an addition to the effect that the insolvency law should also provide for actions taken in violation of the obligations to be invalid. It was also suggested that the recommendation should apply to both individual and corporate debtors.

B. The insolvency representative

82. Some support was expressed in favour of giving more prominence in recommendation (76) to appointment of the insolvency representative by creditors. In response to suggestions that that approach might lead to compromise of the insolvency representative's independence, the attention of the Working Group was drawn to the protections already included in recommendations (77), (79) and (80)(d). A contrary view was the Guide already adequately addressed the interests of creditors and the recommendation should be retained as drafted.

83. With regard to recommendation (77), some support was expressed for the view that a conflict of interest should disqualify an insolvency representative from acting. A contrary view was that although conflicts of interest should be disclosed, the issue of disqualification should ultimately be determined by the court. An additional suggestion was that the recommendation should include a requirement that the insolvency representative be independent of other interests. It was proposed that those requirements concerning conflict of interest and independence should extend to persons employed by the insolvency representative.

84. It was proposed that the obligations of the insolvency representative in recommendation (78) should be cross-referenced to the recommendations concerning the debtor, and corresponding obligations for the insolvency representative to take action be included, such as to take possession of books and records. Further proposals which received some support were that the chapeau should include a reference to the general obligations to maximize the value and protect the security of the estate; that the paragraphs should be reorganized to reflect

a hierarchy of importance ((i) for example, should be included more prominently); that paragraph (b) should provide for the insolvency representative to conduct an examination of the debtor (whether under oath or some equivalent procedure); that paragraph (g) should clarify the parties to whom the information should be provided; that the insolvency representative should be required to provide regular reports to creditors on the progress of the proceedings; that the insolvency representative could exercise rights for the benefit of the estate in respect of court proceedings underway but to which the stay and suspension applied; and that (j) could provide for the creditors committee also to refer matters to the insolvency representative.

85. With respect to recommendation (79) some support was expressed in favour of including more detail in terms of liability arising from recommendations (77) and (78).

86. Some concern was expressed as to the meaning of "circumstances" in recommendation (80).

87. With respect to recommendation (84) it was suggested that the terms of the right of review described by reference to footnote 14 were too broad and required further consideration.

88. A general issue as to the treatment of assetless estates was discussed. The Working Group agreed that those estates should be addressed in the Guide, particularly because an estate could be assetless as a result of transactions which would be subject to avoidance, and the failure to administer such estates might encourage behaviour that the insolvency law otherwise sought to address. It was proposed that the Guide should recommend the need to address such estates and indicate the need for a mechanism for administration to be established, whether through a public agency or some other approach. That mechanism would also address appointment and remuneration of the insolvency representative. A related suggestion was that that issue could also be addressed in respect of some cases under the commencement section.

C. Creditors

89. With respect to section 1, in respect of which no recommendations were yet included in the Guide, it was proposed that the different classes of claims should be addressed, in particular, the need for the insolvency law to clearly identify classes and their treatment. It was noted in response that such a section would have to be closely linked to the section on distribution.

90. Some concern was expressed in relation to the structure of the recommendations, as (89) to (96) clearly related to the committee and should be included under that heading.

91. With regard to the functions of the creditor assembly, support was expressed in favour of including the substance of footnote 19 in the recommendation. A further function could relate to verification of claims. Concern was expressed that the recommendations did not clearly address issues such as the relationship between the assembly and the committee, including whether a committee was always required; the distribution of powers between the two bodies; whether the assembly or the committee should be required to exercise the powers and functions listed; sharing of

the listed powers and functions with the insolvency representative; a mechanism for convening meetings of the assembly; and resolution of conflicts between the assembly and the committee. It was also observed that some countries used mechanisms for representation of creditors other than the assembly or the committee, which might be reflected in the commentary.

92. It was observed that recommendation (87), although establishing an acceptable principle, was less fundamental than the parallel right of the debtor in recommendation (69). It was suggested that the recommendation should indicate the matters in respect of which the creditors should have a right to be heard. It was also suggested that the recommendation should clarify the individual nature of the right.

93. With respect to recommendation (90) support was expressed for reversing the order of the two sentences and clarifying the language of the first sentence with respect to the limitation on the participation of secured creditors to the extent that they were secured. It was also observed that different approaches might be taken to the participation of secured creditors in liquidation and reorganization, particularly where the secured creditors claim was to be restructured and in that situation no limitation should be imposed on its participation.

D. Institutional framework

94. General support was expressed in favour of addressing in the draft Guide issues related to the institutional framework required for implementation of the insolvency law. Some concerns were raised, however, as to the manner in which relevant issues would be treated and the level of detail to be included. It was suggested that while discussion should be included in the commentary, no recommendations should perhaps be included in the technical recommendations on the content of the insolvency law. In preparing the commentary, it was proposed that the Secretariat could have regard to the work of other international institutions, in particular the World Bank and International Monetary Fund. Suggestions as to some of the issues that could be included in the commentary included distribution and balance of responsibility between the participants; case management; supervision of both the insolvency proceedings and the participants in those proceedings, including professionals; disciplinary issues; education and training; and issues of cost-effectiveness and economic functionality. It was proposed that the need for specific recommendations could be further considered when a specific text had been prepared for the Working Group.

5. Management of proceedings

95. As a general remark, it was suggested that chapter V should only include sections A-C, as D and E properly related to resolution of the insolvency proceedings.

A. Treatment of creditor claims

96. It was observed that since paragraph (e) of the Purpose clause included only some examples of different types of claims, but was not exhaustive, it should either be extended to refer to all other claims or all examples be deleted, leaving only a reference to the treatment of particular claims.

97. With respect to recommendation (99), it was suggested that some reference should be made, as a general principle, to the need to establish a mechanism for admission and treatment of claims and for creditors to file claims (or to establish a procedure by which undisputed claims could be automatically admitted) in order for them to participate in insolvency proceedings, as well as to the treatment of claims in reorganization and post-commencement claims. With regard to the establishment of some alternative mechanism for the admission of undisputed claims, support was expressed in favour of the principle, particularly in those circumstances where it would be appropriate to avoid the often complex and lengthy procedures associated with filing and verification of claims. However, in response to the suggestion that the accounting records of the debtor could form a sufficient basis for such admission, it was pointed out that the books and records of an insolvent debtor may not be a good source of uncontested information and some other criteria should be found. It was also suggested that footnote 20 was too categorical; in particular it was observed that the claims of tax authorities were often affected by insolvency law, with those claims being limited or subject to some other constraint. It was agreed that the footnote required revision.

98. As a general remark it was noted that the section on treatment of creditor claims did not address the treatment of under-secured claims, or the question of whether interest would accrue on claims following commencement.

99. Support was expressed in favour of introducing into recommendation (100) the notion of the equal treatment of similarly situated creditors as contained in recommendation (3). A related suggestion was that the minimisation of formalities and easing of restrictions as to the language in which claims might be made, issues that were addressed in the Model Law on Cross-Border Insolvency, should also be reflected in the draft Guide.

100. With respect to recommendation (101)(b), it was noted that where the claim was not filed until late in the proceedings, the creditor would be required to accept that it could not participate in distributions already made.

101. It was observed that the consequences referred to in recommendation (102) differed between countries and the inclusion in the Guide of some comparative information would therefore be useful.

102. With respect to recommendation (103), it was suggested that provision should be made for situations where parties to a contract had agreed to the time at which conversion of the claim would occur.

103. It was observed that the drafting of recommendations (105) and (107) departed from the general formulation of "The insolvency law should ..." and should be revised accordingly. With respect to recommendation (105), it was also suggested that the types of review being proposed should be clarified, whether by the court or some other tribunal, and that the insolvency representative could be allowed to take a decision, in the process of verifying the claim, on the question of set-off.

104. Preference was expressed in favour of the second text in square brackets in recommendation (108)(b).

105. Some concerns were expressed with respect to recommendation (109). It was suggested that the mere fact of a relationship between the claimant and the debtor would not be sufficient in all cases to justify special treatment of a claim. In some cases such claims would be absolutely transparent and in others they might be suspicious. It was noted that some mechanism might be required to address those related party claims that were suspicious or deserved particular attention, and that the draft Guide should make it clear that such treatment was not to be accorded as a matter of course, but would be available in a limited range of situations. It was observed, however, that the treatment of claims described in (109) did not relate to the admission or rejection of a claim, but to the treatment it might be accorded either at the time of admission or at some later time when it became apparent that the related party had caused harm to the estate. It was suggested that the Working Group should take account of the inter-relationship between various recommendations, especially where a number of different approaches were included such as in recommendation (109). For example, where creditors were to play a role in selection of the insolvency representative, related party creditors should not be entitled to participate. A question was raised as to whether (109) was to apply to claims generally and whether any distinction should be made between liquidation and reorganization. After discussion , a suggestion was made to redraft (109) to include paragraph (a) in the chapeau, as well as some reference to the types of situations in which the recommendation might be applicable, along the following lines: "The insolvency law should specify that claims of related parties should be subject to scrutiny and where justified by reference, for example, to undercapitalization of the debtor or self-dealing, then [insert paragraphs (b) and (d)]." That proposal received some support.

B. Post-commencement finance

106. The Working Group generally agreed that the revised provisions reflected the discussion at its twenty-fifth session. Support was expressed for retaining the reference to unreasonable harm in recommendation (114)(a). As a point of clarification, the relevance of the words included in parentheses at the end of recommendation (115) was questioned and it was suggested that the application of the recommendation to a priority given to an unsecured provider of post-commencement finance be made clear. A further suggestion related to the need to link the recommendations with new finance that might be provided under a reorganization plan.

6. Reorganization - additional issues

A. The reorganization plan

107. As a general observation, it was noted that the recommendations concerning the plan did not address the question of interest on claims and how it might be treated.

108. It was suggested that paragraph (a) of the Purpose clause was somewhat vague, and that reference should be made to "the business that was subject to the insolvency law", rather than to "troubled businesses".

109. With respect to recommendation (125), it was suggested that the phrase "but no later than the end of a specified time period" should be replaced by "within a

specified time period". The importance of time periods as a mechanism to end the stay on creditor actions if no plan was presented within the period was stressed. Support was expressed in favour of the time period for submission being fixed by the insolvency law rather than by the court.

110. The reference to the need to identify the party "responsible for preparation of the plan" was felt to be in inappropriate and "identify the parties capable of preparing" was proposed. It was suggested that the recommendation might also address the issue of to whom the proposal for a plan could be made, since it was not always necessary that a plan addressing all creditors be prepared.

111. It was observed that the word "acceptable" in recommendation (127)(b) did not indicate how the question of acceptability was to be addressed and should therefore be deleted.

112. A number of suggestions were made with respect to recommendation (128). These included that paragraph (a) should require some detail to be provided as to the classes of creditors and treatment of their claims, the terms and conditions of the plan, identification of those who would be responsible for the management of the entity into the future, guarantees to be provided by the debtor, whether the assets would be transferred back to the debtor for implementation of the plan, and supervision of the implementation of the plan. It was observed that the reference in (128)(b) to "employment" contracts was different to the terminology used elsewhere in the Guide and should be aligned with that terminology.

113. With respect to recommendation (129), it was suggested that the party responsible for drafting the statement should be identified and information as to how and when it would be provided to creditors should be included. The need for clarification as to whether the statement was an explanatory or disclosure statement was noted. It was suggested in that regard that the information to be included was of the kind that might be required for investment purposes in some jurisdictions and it might therefore be more in the nature of a disclosure statement. Words along the lines of "and that the debtor will have cash flow to pay mature debts" were proposed for addition to the end of paragraph (d).

114. Some clarifications with respect to recommendations (131) and (132) were proposed to more clearly reflect that (131) addressed approval by creditors of a particular class and (132) the issue of approval in the context of all classes of creditors. In recommendation (131) it was implicit that if the required majority of a particular class voted in favour of the plan, that class would be regarded as supporting the plan. In (132), where the required majority was not achieved, the class would be regarded as not approving the plan and would be addressed as dissenting creditors. It was observed that the second criterion concerning lower ranking claims had previously been discussed by the Working Group and some agreement reached to exclude that criterion. All that was required was the criterion included in (133)(b) and (135)(b). Further suggestions with respect to (131) were that the last sentence was not required, that the sentence concerning the combination of amount of claims and number of creditors was too restrictive, and that the reference to voting in person could be expanded to include voting by proxy. It was also noted that some clarification could be provided as to which creditors should be required to vote on approval of the plan. In respect of (132), concern was expressed as to the meaning of the words in square brackets at the end and whether, for

example, four classes of junior classes could bind two classes of more senior creditors.

115. As a general remark with regard to approval of the plan, it was noted that the recommendations as drafted made reference only to approval by the creditors, not by the debtor. If the debtor was not required to participate in the approval process, it was questioned whether the debtor might not be able, as an interested party, to challenge the plan. In that event, paragraphs (a) and (c) of recommendation (135) might be relevant. Some support was expressed in favour of clarifying the meaning of "interested parties".

116. With respect to the issue of confirmation, it was suggested that an additional recommendation might be included concerning the issue of confirmation more generally. That recommendation could then be followed by recommendation (133) redrafted as a positive statement as to when the court should confirm. To the extent that the criteria were not met, the plan could not be confirmed. With regard to paragraph (b), it was observed that the requirement that the court should not confirm in cases where creditors did not receive as much under the plan as in liquidation was inappropriate as it did not take account of commercial realities. It was suggested that where the requirements of the recommendations concerning notice, preparation of the plan and explanatory statement and voting, as well as paragraphs (a) and (c) of (133) had been satisfied, the court should not be able to refuse to confirm. Although the amount to be received might be a factor to be considered by the court, it was pointed out that there were many situations where creditors might agree to receive less under the plan because there were advantages, for example, in receiving an early payment or in the continuing operation of the business of the debtor. In response it was observed that paragraph (b) was intended only as a protection for those creditors who did not vote to approve the plan. A suggestion to address those issues was to add words to the effect of "absent consent of the affected creditors and considering the costs and delays of liquidation" to paragraph (b).

117. Some concern was expressed with regard to the relationship between recommendations (133) and (135). It was suggested that since (135) was capable of applying both to challenges to the approval of the plan and to appeal against the court's decision to confirm a plan, the draft Guide should clearly distinguish the two. It was also suggested that given the requirements for majorities in (131) and (132) and the binding nature of the plan under recommendation (134), it was difficult to understand firstly, how (135) would operate and secondly, the identity of interested parties. Several drafting suggestions to resolve some of those difficulties were made and the Secretariat requested to prepare revised text for consideration at a future meeting.

118. Support was expressed for the view that the reference to discharge in recommendation (134) created some uncertainty as to the time at which discharge might be effective, and might more appropriately be included in recommendations (138) and (139), or amended to indicate that discharge would be effective only after the plan was performed. Some preference was expressed in favour of retaining the reference to commencement of proceedings in the square-bracketed text. It was suggested that the recommendations on the effect of approval of the plan should also address proceedings that had been stayed on commencement of insolvency, recovery by the debtor of management of the entity, and that the use of the terms shareholders, equity holders and owners be clarified.

119. Some concern was expressed with regard to the mechanism for approval of an amendment to a plan under recommendation (136), although it was noted in response that it might not prove too difficult in practice to obtain the agreement of creditors. It was also noted that some insolvency laws imposed a materiality threshold for amendments that required approval of creditors and, if the amended plan were to be more favourable to creditors, no approval was required. It was agreed that more guidance might be required as to mechanisms for approval of amendments.

120. With respect to recommendation (137), it was observed that some insolvency laws did not provide for supervision of implementation of the plan by the court, but enabled creditors to appoint a supervisor, an option which might be reflected in the Guide.

121. As a point of drafting, it was suggested that recommendation (138)(a) should indicate whether termination related to the reorganization proceedings or implementation of the plan. Where reorganization proceedings were converted to liquidation, support was expressed in favour of protecting payments made pursuant to the plan from avoidance in the subsequent liquidation. A further suggestion with respect to recommendation (138)(b) was that conversion to liquidation should be mandatory. It was observed that since there were a number of reasons for which the proceedings might be converted to liquidation, these should all be included in a single provision, such as recommendation (10).

B. Expedited reorganization proceedings

122. The Working Group discussed the topic of expedited reorganization proceedings on the basis of A/CN.9/WG.V/WP.61/Add.1. Wide support was expressed in favour of including such proceedings in the draft Guide and discussing their advantages and benefits. It was recalled that such proceedings had been discussed at the previous session of the Working Group, and reference was made to the explanatory material set forth in A/CN.9/507 (paras. 244-246).

123. Some concerns were expressed, however, as to the scope of the proposal contained in A/CN.9/WG.V/WP.61/Add.1, particularly with respect to the types of creditors that would be involved in such a procedure and its effects on those creditors of the debtor whose interests might not be affected by the plan being proposed; the relationship of such a procedure to both informal negotiations and formal insolvency proceedings; and the effects of commencement of such proceedings, in particular application of the stay.

124. To address those concerns, it was proposed, firstly, that the explanatory material included in A/CN.9/507 be redrafted to form a purpose clause to introduce the recommendations set forth in A/CN.9/WG.V/WP.61/Add.1, and secondly, that the drafting of the recommendations be revised to take account of the Working Group's concerns. That proposal was widely supported.

125. For lack of time the Working Group was not able to consider Chapter V, section C on distribution following liquidation of assets, section D on discharge and section E on closing and reopening of proceedings.

IV. Other issues

1. Intersection of the work of Working Group V (Insolvency law) and Working Group VI (Security interests)

126. The Working Group had before it document A/CN.9/WG.VI/WP.2/Add.10, a report on the treatment of security interests in insolvency proceedings prepared for consideration in the context of the legislative guide on secured interests. The Working Group agreed on the need to ensure a consistent approach by both Working Groups with respect to the treatment of secured interests in insolvency proceedings. It was suggested in that regard that document A/CN.9/WG.VI/WP.2/Add.10 provided a useful summary of the areas in which secured interests intersected with insolvency law and might provide material that could be included in the insolvency Guide to clarify the treatment of secured creditors at each step of insolvency proceedings.

127. Support was expressed for the suggestion that core principles which might govern the intersection of the work on insolvency and secured interests could include that the pre-insolvency priority of security rights should be maintained vis-à-vis other creditors; that secured creditors have the right to the economic value of the secured asset to the extent of their security; that enforcement of the secured right should be subject to the stay; that the secured asset could be used by the debtor; and that the debt secured should be able to be modified in reorganization proceedings.

2. Progress of the work on preparation of a legislative guide on insolvency law

128. The Working Group considered the progress of its work on the development of the legislative guide and the likely timing of completion of that work. General satisfaction was expressed with respect to the progress of the work to date.

129. There was some support for the view that the work might be capable of finalisation by the Commission in 2003, and that the Working Group would be in a better position to make a recommendation on that question at the completion of its 27th session in December 2002.

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Corrigendum

Footnote 1 should refer to paras. 400-409 of document A/55/17.

Footnote 2 Footnote 2 should refer to document A/56/17.

In paragraph 23, the reference to recommendation (5) should be to recommendation (6).

In paragraph 57, the second sentence should read, for clarity, "The use of the phrase "fair treatment" was queried in the light of the earlier discussion on the key objectives and the use of the terms "equal" and "equitable" treatment.

In paragraph 103, the reference to recommendations (105) and (106) in the first line should be to recommendations (106) and (107).

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I. Introduction

1. At its present session, Working Group VI (Security Interests) began its work on the development of "an efficient legal regime for security rights in goods involved in a commercial activity ... ".[1]

2. The Commission's decision to undertake work in the area of secured credit law was taken in response to the need for an efficient legal regime that would remove legal obstacles to secured credit and could thus have a beneficial impact on the availability and the cost of credit.[2]

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[1] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 18*, A/55/18, para. 358.

[2] Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 455, and *Fifty-sixth Session, Supplement No. 17* (A/56/17), para. 347.

3. At its thirty-third session in 2000, the Commission considered a report of the Secretary-General on possible future work in the area of secured credit law (A/CN.9/475). At that session, the Commission agreed that security interests was an important subject and had been brought to the attention of the Commission at the right time, in particular in view of the close link of security interests with the work of the Commission on insolvency law. It was widely felt that modern secured credit laws could have a significant impact on the availability and the cost of credit and thus on international trade. It was also widely felt that modern secured credit laws could alleviate the inequalities in the access to lower-cost credit between parties in developed countries and parties in developing countries, and in the share such parties had in the benefits of international trade. A note of caution was struck, however, in that regard to the effect that such laws needed to strike an appropriate balance in the treatment of privileged, secured and unsecured creditors so as to become acceptable to States. It was also stated that, in view of the divergent policies of States, a flexible approach aimed at the preparation of a set of principles with a guide, rather than a model law, would be advisable. Furthermore, in order to ensure the optimal benefits from law reform, including financial-crisis prevention, poverty reduction and facilitation of debt financing as an engine for economic growth, any effort on security interests would need to be co-ordinated with efforts on insolvency law.[3]

4. At its thirty-fourth session in 2001, the Commission considered a further report by the Secretariat (A/CN.9/496). At that session, the Commission agreed that work should be undertaken in view of the beneficial economic impact of a modern secured credit law. It was stated that experience had shown that deficiencies in that area could have major negative effects on a country's economic and financial system. It was also stated that an effective and predictable legal framework had both short- and long-term macroeconomic benefits. In the short term, namely, when countries faced crises in their financial sector, an effective and predictable legal framework was necessary, in particular in terms of enforcement of financial claims, to assist the banks and other financial institutions in controlling the deterioration of their claims through quick enforcement mechanisms and to facilitate corporate restructuring by providing a vehicle that would create incentives for interim financing. In the longer term, a flexible and effective legal framework for security rights could serve as a useful tool to increase economic growth. Indeed, without access to affordable credit, economic growth, competitiveness and international trade could not be fostered, with enterprises being prevented from expanding to meet their full potential.[4]

5. While some concerns were expressed with respect to the feasibility of work in the field of secured credit law, the Commission noted that those concerns were not widely shared and went on to consider the scope of work.[5] It was widely felt that work should focus on security interests in goods involved in a commercial activity, including inventory. It was also agreed that securities and intellectual property should not be dealt with. With respect to securities, the Commission noted the interest of the International Institute on Private Law (Unidroit). As to intellectual

[3] *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 459.

[4] Ibid., *Fifty-sixth Session, Supplement No. 17* (A/56/17), para. 351.

[5] Ibid., paras. 352-354.

property, it was stated that there was less need for work in that area, the issues were extremely complex and any efforts to address them should be co-ordinated with other organizations, such as the World Intellectual Property Organization (WIPO).[6] As to the form of work, the Commission considered that a model law might be too rigid and noted the suggestions made for a set of principles with a legislative guide that would include, where feasible, model legislative provisions.[7] After discussion, the Commission decided to entrust a working group with the task of developing an efficient legal regime for security rights in goods involved in a commercial activity, including inventory. Emphasizing the importance of the matter and the need to consult with representatives of the relevant industry and practice, the Commission recommended that a two- to three-day colloquium be held.[8] The colloquium was held in Vienna from 20 to 22 March 2002. The report of the colloquium is contained in document A/CN.9/WG.VI/WP.3.

6. The Working Group, which was composed of all States members of the Commission, held its first session in New York from 20 to 24 May 2002. The session was attended by representatives of the following States members of the Commission: Austria, Brazil, Burkina Faso, Cameroon, Canada, China, Colombia, France, Germany, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Mexico, Spain, Sweden, Thailand and United States of America.

7. The session was attended by observers from the following States: Argentina, Australia, Belarus, Cyprus, Ecuador, Indonesia, Jordan, Peru, Philippines, Poland, Portugal, Republic of Korea, Switzerland and Venezuela.

8. The session was also attended by observers from the following national or international organizations: the American Bar Association, the Association of the Bar of the City of New York (ABCNY), the Commercial Finance Association (CFA), Federación Latinoamericana de Bancos (FELABAN), the International Association of Ports and Harbors (IAPH), the International Bank for Reconstruction and Development (the World Bank), the International Chamber of Commerce, (ICC), the International Federation of Insolvency Practitioners (INSOL), the International Institute for the Unification of Private Law (UNIDROIT), the International Law Association (ILA), the International Monetary Fund (IMF), the Max-Planck Institute for Foreign and Private International Law (MPI), the National Law Centre for Inter-American Free Trade, the Union of Industrial and Employers'Confederation of Europe (UNICE) and Union Internationale des Avocats (UIA).

9. The Working Group elected the following officers:

Chairman: Ms. Kathryn Sabo (Canada);

Rapporteur: Mr. Abbas Saffarian (Islamic Republic of Iran).

10. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.1 (provisional agenda), A/CN.9/WG.VI/WP.2 and Addenda 1 through 12 (Draft legislative guide on secured transactions), A/CN.9/WG.VI/WP.3 (report on UNCITRAL-CFA international colloquium on secured transactions

[6] Ibid., paras. 354-356.
[7] Ibid., para. 357.
[8] Ibid., para. 359.

(Vienna, 20-22 March 2002)) and A/CN.9/WG.VI/WP.4 (comments by the European Bank for Reconstruction and Development).

11. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a legislative guide on secured transactions.
4. Other business.
5. Adoption of the report.

II. Deliberations and decisions

12. The Working Group considered chapters I to V and X of the draft Guide. The deliberations and decisions of the Working Group are set forth below in part III. The Secretariat was requested to prepare, on the basis of those deliberations and decisions, a revised version of chapters I to V and X of the draft guide.

III. Preparation of a legislative guide on secured transactions

General remarks

13. General support was expressed for the preparation of a legislative guide on secured transactions. It was widely felt that an efficient secured transactions regime could have a positive impact on the availability of credit at affordable rates. It was also stated that the Commission's work was particularly timely as it was also preparing a legislative guide on insolvency law and could thus provide comprehensive and harmonized guidance to States. Particular emphasis was placed on the need to ensure harmony with insolvency laws, to build on texts completed by other organizations and to avoid duplication with texts currently under preparation in other organizations. In that connection, the Working Group was reminded, in particular, of the need to coordinate with Working Group V (Insolvency Law), and of the decision of the Commission not to deal with security rights in securities or intellectual property.[9] The Working Group noted that the International Institute for the Unification of Private Law (UNIDROIT) had set up a study group whose mandate was to prepare harmonized rules on the taking of security in securities, and expressed its wish that the Secretariat identify the most efficient way of coordination with UNIDROIT (see also paras. 32 and 37).

14. As to the form of work, in response to a question raised, it was noted that a model law or a convention would be too rigid, while a guide with legislative recommendations would be a more flexible and yet sufficiently useful text. It was also noted that, once the draft Guide had been completed, the Commission could consider the question of preparing a model law.

[9] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* (A/56/17), paras. 354-356.

Chapter I. Introduction

A. Organization and scope

15. While general support was expressed for the discussion in the draft Guide of the economic impact of secured transactions legislation, it was widely felt that the discussion should be stated in such a way so as not to suggest that, even though appropriate legislation was a necessary condition for a certain economic result, it was in itself sufficient to achieve that result. In that connection, it was stated that reference should be made, for example, to the appropriate infrastructure, judicial system and enforcement mechanisms necessary to ensure that a State enacting legislation based on the regime envisaged in the draft Guide ("enacting State") could obtain the economic benefits referred to in the draft Guide (i.e. increased access to credit at the appropriate credit terms and cost).

16. In addition, it was observed that the cost of establishing and applying the regime envisaged in the draft Guide should also be discussed, at least with a view to addressing concerns that some States might have. Moreover, it was said that emphasis should be placed on the potential impact of secured transactions law (e.g. priority) on insolvency law, in particular in the case of reorganization proceedings, and on the need to ensure a proper balance between the interests, on the one hand, of debtors and creditors and, on the other hand, of secured, unsecured and privileged creditors (see also para. 23).

17. The Working Group agreed that the scope of the regime envisaged in the draft Guide should be described more clearly. It was stated that work could first focus on goods, including inventory, and then possibly expand, if necessary, to other assets, such as receivables, provided that the main rules dealing with security rights in goods would not be affected. It was also observed that the more comprehensive the regime envisaged in the draft Guide, the more value it would have for legislators. The example was given of the importance of addressing enterprise mortgages that could encompass both movable and immovable property. In response, it was observed, however, that security rights in immovable property gave rise to different issues from those arising in the context of security rights in movable property and was thus treated in separate statutes. It was also said that the fact that such security rights were treated in separate statutes did not raise any problem. It was stated, however, that treating assets of an enterprise in separate statutes could raise problems of enforcement and complicate the sale of the enterprise as a going concern. In that connection, it was stated that, whether the regime envisaged in the draft Guide would apply to security rights in immovables or not, the draft Guide needed to inform enacting States of the need to ensure that the secured transactions legislation would not overlap or be in conflict with other legislation.

18. Differing views were expressed as to whether the regime envisaged in the draft Guide should cover consumer transactions. One view was that consumer transactions should be excluded altogether. It was stated, however, that, if such an approach were to be taken, it would have to be explained in the draft Guide. Another view was that consumer transactions should be addressed, provided that the rights of consumers under applicable consumer protection law would not be affected. It was observed that that result could be achieved by subjecting consumer

transactions to the same rules applicable to commercial transactions, introducing exceptions only where necessary to protect rights of consumers under consumer protection law.

19. In the discussion, the suggestion was also made that the draft Guide should discuss in more detail the problem of the cross-border recognition of security rights that were in many cases effectively lost once the encumbered assets were transported across national borders.

20. The Working Group took note of the suggestions made and, on the understanding that it might have to revisit scope-related issues in the context of its discussion of substantive issues, requested the Secretariat to address them in the next version of the draft Guide.

B. Terminology

21. It was agreed that terminology could be more usefully discussed in the context in which the substantive matters addressed in each definition arose in the draft Guide. However, several suggestions were made, including the suggestions to: limit the definition of "debtor" to commercial debtors (see para. 18); to refer in the definition of "encumbered assets" to immovable property and not only in the context of enterprise mortgages. In that connection, the concern was expressed that such an approach would result in inappropriately expanding the scope of the draft Guide (see para. 17).

C. Examples of financing practices

22. The Working Group took note of the list of examples of financing practices given in the draft Guide and agreed to consider at a later stage whether to expand that list and whether to place it in chapter I or elsewhere in the draft Guide.

Chapter II. Key objectives

23. General support was expressed for a general statement along the lines of chapter II of the main practical objectives of the regime envisaged in the draft Guide. At the same time, a number of suggestions were made including the suggestions to: refer in objective A to "fair" rather than to "full" value; refer in objective C to the value of registration systems; revise the reference in objective E to court proceedings being time-consuming, since that might not be an accurate statement of the situation prevailing in all countries and, in any case, in many countries there were expedited court proceedings; add a new objective referring to the need to protect the interests of debtors; reflect more clearly the impact of secured transactions legislation on credit discipline and corporate governance; make it clear in objective H that there were other ways to promote responsible behaviour, and not just transparency, since debtors might not wish to disclose details about their financing transactions; and to add another objective to refer to the need to protect the interests of various types of creditors (e.g. secured, unsecured and privileged creditors, within or outside insolvency proceedings, as well as to long-term and short-term creditors).

24. It was also suggested that, beyond balance between debtors and creditors, as well as among various types of creditors, balance between the various objectives should also be achieved, since, for example, simplicity might be inconsistent with transparency and speedy enforcement might be inconsistent with a balanced approach to the rights of all parties. As to party autonomy, it was also stated that it might need to be limited in a regime dealing with proprietary rights (*in rem*) that, by definition, might affect the rights of third parties. The need to consider the objectives in the light of the main financing transactions to be covered in the draft Guide was also highlighted.

25. As to registration, while it was agreed that it was a useful concept and should be discussed, it was stated that it was not an objective but rather related to the means for achieving one or more objectives. Reference was also made to studies by the Asian Development Bank, emphasizing the economic importance of registration systems, and to projects in various Asian countries aimed at the introduction of such registration systems.

26. On the understanding that it might have to revisit the key objectives in the context of its discussion of subsequent chapters, the Working Group requested the Secretariat to revise them to take into account the suggestions made and the views expressed.

Chapter III. Basic approaches to security

27. It was stated that it should be made clear right at the beginning of chapter III that it was intended to provide an indication of the various approaches to the notion of security, the advantages and disadvantages of each approach and the various policy options before legislators.

A. Pledge

28. Support was expressed for the discussion of advantages and disadvantages a pledge presented for the debtor and the secured creditor. It was observed that reference should also be made to the advantages of pledge-type security rights for third parties and, in particular, to the fact that it minimized the risk of fraud. With respect to liability of creditors in possession (for example, for contamination of the environment), it was stated that the draft Guide should discuss in more detail existing legislation exempting the creditor from liability in cases where the creditor had no effective control of the encumbered asset, and include a recommendation along those lines. It was observed that, if the creditor was not exempted from such liability, it would have to take insurance, the cost of which would be paid by the debtor and could significantly raise transaction costs.

29. In response to a question as to whether the creditor and the person holding the security right or the encumbered asset could be two different persons, it was noted that an agent or trustee could hold the right or the encumbered asset on behalf of the secured creditor, without becoming a secured creditor. It was agreed that the matter could be usefully explained in the draft Guide.

B. Right of retention of possession

30. Support was expressed for the discussion in the draft Guide of the right of retention of an asset by a party whose contractual partner failed to perform its obligations under the contract, since it was treated in some jurisdictions as a security right. However, a number of concerns were expressed with respect to the current formulation of the relevant issues in the draft Guide. One concern was that it was not sufficiently clear that a right of retention could be statutory or consensual and that the former should be excluded from the scope of the draft Guide, while the latter could be addressed. Another concern was that the right of retention, which was a contractual right even if accompanied with an authorization to a party to sell the asset, was presented as a property right. Yet another concern was that priority in payment, which was more relevant in the context of a discussion of security rights, was not discussed. Yet another concern was that the current discussion of the matter might be inadvertently understood as allowing a party to sell an asset without court authorization, where necessary.

C. Non-possessory security

31. While a discussion of non-possessory security was generally thought to be appropriate, a number of suggestions were made including the suggestions to: expand on the description of non-possessory security rights to avoid giving the impression that the debate over whether to allow non-possessory security rights was new or inconsistent with legal traditions in various civil law countries; discuss publicity as a solution to the issue of false wealth arising in the context of non-possessory security rights, but also as a tool to provide to third parties (including insolvency administrators) information on the basis of which to assess the risk of non-payment; address the question whether the secured creditor had the same rights where assets subject to an all-asset security right (global security right or "floating charge") changed; refer to the Model Inter-American Law on Secured transactions, prepared by the Organization of American States ("the OAS Model Law"), as a law covering both possessory and non-possessory security; and emphasize that treating possessory and non-possessory security rights in separate statutes could lead to inconsistencies, lack of transparency and gaps. In that connection, it was suggested that the matter needed to be discussed further as many States had asset-specific legislation with respect to non-possessory security rights.

D. Security in intangibles

32. In response to a question, it was noted that the draft Guide discussed security rights in intangibles since, in line with one of the key objectives of any efficient secured transactions system, it was based on the assumption that its scope would be as broad as possible. It was stated that, while the question of addressing security rights in some types of intangible assets should be discussed at some point of time, the Working Group should focus on security rights in goods, including inventory. It was also observed that intangibles should be discussed because of their economic value and their importance in the context of all-asset security right or enterprise mortgages. In addition, it was pointed out that intangible assets, such as receivables and proceeds of goods, needed to be given particular attention. The need to coordinate with, and complement work by, other organizations was also emphasized (see also paras. 13 and 37).

E. Transfer of title

33. It was widely felt that transfer of title was appropriately discussed in the draft Guide. At the same time, a number of suggestions were made including the suggestions to: clarify that transfer of title had been developed to circumvent the prohibition of or difficulties with non-possessory security rights and that it was not needed to the same extent in systems with modern regimes on non-possessory rights; address the question whether assets subject to a transfer-of-title security device were part of the grantor's insolvency estate; and highlight the fact that transfer of title was subject to reduced formal requirements.

F. Retention of title

34. Support was expressed for the discussion of retention of title in the draft Guide. It was stated that insolvency administrators went to great length and cost to address the question whether retention of title was a security right or not. It was, therefore, suggested that the draft Guide could make a significant contribution to practice by recommending that retention of title should be treated as a security right. However, the Working Group made no decision as to whether retention-of-title arrangements should be regarded as conditional sales or secured transactions.

G. Uniform comprehensive security

35. It was widely felt that the draft Guide should discuss both approaches taken in legal systems towards a uniform security right in all types of asset. It was stated that one approach was to abolish all existing security rights and to introduce a new one that could be created in all types of asset. As to title arrangements, it was observed that, in the context of such an approach, they could be identified and treated in the same way security rights were treated. The second approach was said to be the one currently discussed in the draft Guide, in the context of which, instead of creating a new security right, the functional equivalents of a security right were subjected to the same rules.

H. Summary and recommendations

36. The Working Group agreed that the section entitled "summary and recommendations" could be retained on the understanding that it would be restructured to form a summary and some tentative conclusions for further consideration, since it was premature at the present stage to formulate any recommendations. It was stated that it was appropriate for this chapter to set out the different security devices, their advantages and disadvantages, and the various options available to legislators. It was also observed that the chapter should be as comprehensive as possible and leave open the way in which the various approaches could be implemented. It was also stated that the draft Guide should express clear recommendations rather than focus merely on the description of existing practices.

37. As to the right of retention of possession, it was stated that reference should be made to the priority of the party having a right of retention. With respect to non-possessory security rights, it was observed that their treatment in the case of insolvency needed to be discussed in some detail. With respect to intangibles, it was pointed out that, while some types of intangibles (e.g. receivables and proceeds of

goods) should be covered, other types (e.g. securities and intellectual property rights) should not be covered in view of the need to focus on security rights in goods, the complexity of issues relating to security rights in securities, the need to use efficiently the resources of the Working Group with a view to completing its work within a reasonable period of time and the need to avoid duplication of efforts with other organizations (see also paras. 13 and 32).

38. After discussion, the Working Group requested the Secretariat to revise chapter III of the draft Guide taking into account the views expressed and the suggestions made.

Chapter IV. Creation

39. It was stated that the presentation of the contents of the chapter in the introduction was helpful for the reader and should be considered for other chapters as well. It was also observed that the types of debtors and creditors to be covered should also be discussed. Support was expressed for the principle that secured transactions would be subject to insolvency rules relating to avoidance of preferential, undervalued and fraudulent transactions.

A. Accessory nature of security right

40. It was suggested that the discussion of the principle of the accessory nature of a security right should be revised to make clear that a security right was always accessory to the secured obligation in the sense that the validity and terms of the security right depended on the validity and the terms of the secured obligation even in revolving credit transactions.

B. Obligations to be secured

41. A number of suggestions were made, including the suggestions to: revise the discussion of monetary and non-monetary obligations so as to avoid any discrimination against non-monetary obligations; clarify that a security right securing a future obligation could not be enforced, rather than have no effect, before the obligation actually arose; clarify that some modern systems required parties to set a maximum limit to the obligation to be secured, while other modern systems did not have such a requirement.

42. Differing views were expressed as to whether the draft Guide should recommend a maximum limit to the secured obligation. One view was that such a limit would make it possible for the debtor to use its assets to obtain credit from another party. It was observed that that matter was addressed in the draft Guide (fluctuating amounts and description of secured obligation) with the presentation of two options. One option was to allow for the determination of the amount of the secured obligation in a general way, and the other option was to allow an all-sums security. Another view was that the matter should be put in a practical context and the advantages and disadvantages of the various options should be discussed. It was explained that, unless the encumbered asset could be evaluated with some precision (as was the case, for example, with real property), maximum limits were not helpful. In such cases, the benefit to be derived for the debtor from making it possible for the debtor to use its assets to obtain security from another creditor

might not outweigh the benefits arising from the debtor putting no limit to the amount of the secured obligation (e.g. increased amount of credit at lower cost than otherwise). It was agreed that the matter needed to be discussed further in the context of the discussion of chapters V (A/CN.9/WG.VI/WP.2/Add.5, paras. 35-37) and VI (A/CN.9/WG.VI/WP.2/Add.6, paras. 11-12). It was also agreed that in chapter IV cross-references should be included to those chapters.

C. Assets to be encumbered

43. With respect to possible limitations, it was stated that both possible approaches should be discussed (property could not be encumbered at all or could be encumbered only up to a certain amount). It was also suggested that the draft Guide should clarify whether it was the asset that was encumbered or the right of the grantor in the asset. In that connection, it was explained that the draft Guide was based on the assumption that the security right was in the property of the grantor in the asset and not in the asset itself. It was also explained that the draft Guide discussed also the possibility of the grantor creating a security right in an asset that the grantor did not own or could not dispose of at the time of the creation of the security right (see A/CN.9/WG.VI/WP.2/Add.4, paras. 48-51). Some doubt was expressed as to whether the security right was in the right of the grantor or in the asset itself. The Working Group agreed to revisit that matter.

44. Support was expressed for allowing security to be created in assets not existing at the time of the conclusion of the security agreement ("future assets") as well as in assets acquired after the conclusion of the security agreement ("after-acquired assets"). It was also stated that a description, such as "all assets", should be sufficient.

45. With respect to security in all assets of an enterprise ("floating charge"), it was stated that it should be discussed in more detail, with particular reference to the concept of "crystallization" of the security to particular assets. It was also observed that an all-assets security was not equivalent to an enterprise mortgage, because, inter alia, the latter could include also immovable property (enforcement was subject to the same rules but not registration). With respect to the advantage of an enterprise mortgage mentioned in the draft Guide (i.e. the appointment of an administrator upon enforcement), it was observed that in practice that did not always prove to be an advantage since administrators appointed by secured creditors tended to favour secured creditors to the detriment of other creditors. It was also pointed out that recent studies in some countries had shown that enterprise mortgages might not be as advantageous as was originally thought, since banks often failed to monitor the assets and thus contribute to the preservation of a business, while they had no interests in actively participating in reorganization proceedings, since they were fully secured. After discussion, it was agreed that the relationship between an all-assets security and an enterprise mortgage should be discussed in more detail.

46. As to the issue of over-collateralization arising in some legal systems as a result of an all-assets security or an enterprise mortgage, it was stated that it should be discussed in a more balanced way to highlight both the advantages and disadvantages of an all-assets security. One advantage mentioned, for example, was the reduction of the cost of monitoring the encumbered assets. One disadvantage mentioned was that it resulted in the one-banker problem, namely that the debtor

was forced to obtain credit from only the banker to whom the debtor had given an all assets-security. In response, it was stated that that might not be a real problem since in practice there was fierce competition and the debtor could refinance its debt. On the other hand, it was observed that such refinancing had some cost. It was stated though that that cost was not the result of the all-assets security but was inherent in any refinancing. It was also observed that whether the debtor could obtain security from another party depended on the relationship between the value of its assets and the amount of the secured obligation.

D. Proceeds

47. Differing views were expressed as to whether civil fruits and proceeds could be grouped into the notion of proceeds and be subjected to the same rules. One view was that civil fruits and proceeds were two distinct notions and should not be subject to the same rules. Another view was that distinctions between these two notions were often very difficult to draw and, in any case, subjecting them to different rules could not be justified in view of the relationship between proceeds and fruits on the one hand and the original encumbered asset on the other hand. To clarify that relationship, it was said that distribution of fruits (e.g. dividends) was bound to affect the value of the original encumbered asset (e.g. stocks). To bridge the gap between the two views, it was suggested that, while terminological differences could be preserved, both proceeds and fruits should be treated as falling within the scope of the encumbered asset.

48. Recognition by the law of an automatic right of the secured creditor in proceeds was generally considered as one approach to the issue. It was stated that such a rule would function as a default rule applicable in the absence of contrary agreement of the parties. It was suggested that the other approach should also be mentioned, namely that parties could agree on extending the security right, for example, to inventory, receivables, negotiable instruments and cash. Such an approach could be taken in legal systems that allowed security to be taken in all types of asset, including future and after-acquired assets. It was explained that, in such a case, the right of the secured creditor would be a right in original encumbered assets described in the security agreement and not a right in proceeds. In response, it was stated that various approaches could be considered as long as they led to an acceptable practical result, keeping in mind that the regime envisaged in the draft Guide should include clear rules as to priority in proceeds (A/CN.9/WG.VI/WP.2/ Add.7, paras. 51-59).

49. The Working Group generally agreed that the questions mentioned in the draft Guide with respect to proceeds (A/CN.9/WG.VI/WP.2/Add.4, para. 33) were appropriately raised and requested the Secretariat to discuss possible efficient approaches, explaining the advantages and disadvantages of each approach. Particular emphasis was placed on the question whether the right in proceeds was the same as the security right (i.e. a right *in rem*) or a new right (i.e. a personal right), as well as to the time when proceeds should be "identifiable" as proceeds.

50. The concern was expressed that the reference to publicity as a way to protect third parties that relied on the proceeds as original encumbered assets might inappropriately give the impression that there were no other ways to protect third parties. In that connection, it was noted that one of the fundamental working assumptions in the draft Guide was that publicity was the most efficient way to

protect third parties, in particular in the case of non-possessory security rights. It was also noted that the mandate of the Working Group was to "develop an efficient legal regime for security rights in goods"[10] and not to collect information about and reflect all possible approaches, irrespective of whether they were generally thought to work in practice or not.

E. Security agreement

51. As to the parties to the security agreement, it was suggested that reference should be made also to the third-party security holder. That suggestion was objected to on the grounds that that third party was an agent of the secured party and had no rights of its own.

52. As to the minimum contents of the security agreement, it was stated that they should be reduced since their absence could result in an agreement being invalid. It was also said that such an approach would be in line with one of the key objectives of any efficient secured transactions regime, namely to ensure that security could be obtained in a simple and efficient manner. In particular as to the signature of the grantor, it was observed that it presupposed writing, which was not necessary in all cases. It was also said that it was not clear why the signature of the debtor was not required. Furthermore, it was said that secured creditors could be warned of the possible consequences of the absence of one of the elements mentioned from their agreements, without indirectly encouraging judges to look for grounds to invalidate such agreements.

53. While there was general agreement that formalities should be reduced to a minimum, differing views were expressed as to whether writing should be required for the security agreement to be valid. One view was that writing should not be a condition for the validity of the security agreement. It was stated that, as between the parties to the agreement, writing fulfilled a warning and an evidentiary function, while, as against third parties, writing fulfilled a fraud-prevention function. In that connection, it was observed that parties to sophisticated financing transactions did not need a warning or proof of the agreement, which could be provided by other means. As to third parties, it was pointed out that they could be protected from fraudulent ante-dating by some form of publicity. It was stated, however, that writing would be necessary, irrespective of the form of publicity. In the case of a document registry, writing was necessary since the written agreement had to be registered. In the case of a notice registry, writing was necessary, since notice did not establish the validity of the security agreement.

54. Another view was that writing should be required only for non-possessory security rights. It was observed that possession of the encumbered asset by the secured creditor was sufficient to fulfil the function that writing would fulfil (i.e. proof and prevention of fraudulent ante-dating). Yet another related view was that writing could be required as proof of the agreement not between the parties but only if it was challenged by a third party. It was stated that such an approach would be based on a clear distinction between publicity and writing, notwithstanding the third-party effects of writing.

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[10] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 18*, A/55/18, para. 358.

55. Yet another view was that writing was necessary not only as between the parties to the agreement but also as against third parties. It was stated that often writing was required in particular for banking transactions and consumer transactions. It was also pointed out that, irrespective of whether the agreement needed to be in written form for it to be valid *inter partes*, it had to be in writing for execution purposes, as well as for it to be accepted as valid in the context of insolvency. It was stated, however, that, if a written form requirement was introduced, the impact in particular on informal transactions relating, for example, to retention-of-title arrangements, that were often reflected only in the seller's general terms and conditions, would have to be carefully examined. In response, it was stated that, in the absence of writing, retention-of-title arrangements were not recognized in insolvency proceedings even in countries that did not require writing for the *inter partes* validity of such transactions.

56. After discussion, the Working Group requested the Secretariat to revise the discussion of the security agreement in the draft Guide to reflect the views expressed and the suggestions made. In particular with respect to written form requirements, the Working Group requested the Secretariat to discuss the advantages and disadvantages of the various approaches, drawing, where necessary, distinctions between possessory and non-possessory security rights.

F. Other requirements for the creation of a security right

57. It was noted that, in many legal systems, the security agreement did not suffice to create a security right. Other requirements should also be met. For example, the grantor should have ownership (or some other property right) in the asset to be encumbered; in the case of a possessory security right, possession should be given to the secured creditor; in the case of a non-possessory security right in tangibles, the right should be publicized; in the case of a non-possessory security right in intangibles, control of the right should be given to the secured creditor.

58. It was suggested that the issue whether only the owner of an asset or also the holder of a lesser right could grant a security right should be discussed in more detail. In response to a question, it was explained that a creditor could acquire a security right in good faith even if the grantor was not the owner or did not have the right to dispose of the asset, provided that the creditor had extended or had made a commitment to extend credit.

59. A reservation was expressed with respect to the use of the term "possession" as it implied that a person holding an asset did so on the basis that that person was the owner of or had some other property right in the asset. In order to address that concern, it was noted that, while use of the term "possession" in English was appropriate, in other language versions reference could be made to "detention".

60. As to possession, publicity or control, it was stated that it needed to be clarified that possession was relevant only for possessory security rights, publicity was relevant for non-possessory security rights (in tangibles) and control for non-possessory security rights (in intangibles).

G. Summary and recommendations

61. It was noted that the recommendation as to the types of obligations that could be secured and the assets that could be encumbered did not deal with issues, such as

limits on the amount of the secured obligation or all-assets security rights. It was also noted that the recommendation as to rights in identifiable proceeds reflected a principle of the United Nations Convention on the Assignment of Receivables in International Trade. On that understanding, these recommendations received wide support. As to the recommendation on form requirements, it was agreed that it would be revised to reflect the discussion of the matter by the Working Group.

62. After discussion, the Working Group requested the Secretariat to revise chapter IV taking into account the views expressed and the suggestions made.

Chapter V. Publicity

A. Introduction

63. Differing views were expressed as to the need for a publicity system for security rights in movable property. One view was that such a publicity system was not necessary. In support, it was stated that, in a credit-dominated economy, parties ought to know that assets were likely to be encumbered or be subject to a quasi-security device (e.g. retention of title or lease). It was also observed that the information provided in the encumbrance registry envisaged in the draft Guide would be either too much and thus raise issues of confidentiality and competition, or too little and thus be of no use. In particular with regard to confidentiality, it was pointed out that, in order to preserve it, many countries had no general credit reporting system or property registry. If the draft Guide was to be addressed to such countries, it was said, it should discuss the advantages and disadvantages of all possible publicity systems. In addition, it was said that an encumbrance registry might be too costly to establish and operate, with the result of increased transaction costs. Moreover, it was stated that the current version of the draft Guide was not sufficiently balanced in that it did not present alternative publicity systems to registration. Alternatives mentioned included information available on balance sheets, company records or local banking systems (see A/CN.9/WG.VI/WP.2/Add.5, para. 44).

64. The prevailing view, however, was that a registry system was a crucial element of any modern and efficient secured transactions regime. It was stated that such a system replicated the publicity function of possession of an asset and was based on a universal principle of publicity and transparency. It was also observed that the system did not disclose confidential information and was beneficial to all parties concerned: debtors, because it allowed them to obtain access to credit at a cost lower and more expeditiously than in systems where information about the assets of the debtor was not readily available; creditors, because it allowed them to extend credit with relative certainty as to their rights; and third parties, because it put them on notice as to potential encumbrances in the assets of the debtor and provided an objective priority regime. In addition, it was observed that the principle of publicity and transparency had become a basic requirement in regulatory banking law to the extent that both central and commercial banks were required to do extensive credit checking with respect to borrowers. It was also pointed out that a major portion of interest rates (close to 60 per cent) was intended to cover risks arising out of lack of sufficient information on borrowers. Reference was also made to project financing and securitization practices, which were of crucial importance for the financing, in particular, of infrastructure projects and yet could not flourish in the absence of a

reliable registration system. Moreover, it was stated that absolute secrecy with respect to secured transactions meant absolute power of secured creditors over debtors, since the creditor with intimate information about a borrower with whom that creditor had a long-standing relationship effectively controlled and thus deprived that debtor of the benefits to be derived from the access to competitive banking markets.

65. While the Working Group confirmed its interest in a registry for security rights in movables, several concerns were also raised. Issues of concern mentioned included: the purpose of publicity; the scope of the registry; the cost of establishing and operating the registry; and costs for the industry to take advantage of the registry. In response, it was stated that the purpose and the scope of the registration system was set out in the draft Guide and could be discussed in detail. It was also observed that the fact that some of the least developed countries in the world had established and operated registry systems, such as the one described in the draft Guide, was a clear indication that it was cost-efficient. In that connection, it was mentioned that, in light of the advances of computer technology, registration systems could be established quickly and inexpensively and could be operated on a cost-recovery basis with nominal flat-rate, registration fees. In order to provide information necessary to address the concerns expressed, a number of suggestions were made, including the suggestions to: have a presentation of a modern registration system at the next meeting of the Working Group; and set up an informal *ad hoc* group in the context of which interested delegations could discuss practical registration-related issues.

66. In that connection, reference was made to the Convention on International Interests in Mobile Equipment (Cape Town, 2001) and the Aircraft Protocol, as well as to the OAS Model Law, which provided for publicity through the registration of limited data in a publicly accessible registry to deal with priority issues. With respect to the Convention and the Aircraft Protocol, however, it was observed that they involved a registry that was somehow different from the one envisaged in the draft Guide in that it would be international, asset-based (i.e. it would involve the identification of the encumbered asset, not the debtor, by a unique serial number) and referred only to high-value equipment. As to the OAS Model Law, it was stated that it established a registry system, such as the one envisaged in the draft Guide, which was cost-effective, comprehensive and accessible to the public and indicated the policy of the thirty-four countries participating in the OAS process to establish a dynamic, regional credit market.

67. After discussion, the Working Group decided to proceed with the examination of chapter V based on the working assumption that a publicity system, such as the one discussed in chapter V, would be part of the regime envisaged in the draft Guide.

B. Title transactions vs. security transactions

68. It was noted that the Working Group should address two key questions; first, whether transactions involving the transfer or retention of title for security purposes should be subject to registration; and second, whether certain pure title transactions should be subject to registration (e.g. long-term leases and outright assignments). A related question mentioned was whether, if certain pure title transactions were to be subject to registration, the approach to be taken should be based on an illustrative

list of transactions or on a problem-oriented concept so as to ensure that transactions in which ownership and possession were separated would be subject to registration.

69. With respect to title transactions that were functionally equivalent to secured transactions, the view was expressed that they should not be subject to registration. It was reiterated that their existence was generally known in the market and, in any case, the registry envisaged in the draft Guide provided either too much or very little information (see para. 63). It was also stated that such an approach might make it necessary for parties to true title transactions to register so as to obtain priority, a result that could inadvertently raise their cost.

70. On the other hand, the view was expressed that title transactions should be covered, at least to the extent that they served security purposes. It was stated that, if title transactions that were functionally equivalent to secured transactions were not subject to registration, the registry system could not provide reliable information as to the existence of rights that could deprive secured creditors of the asset value they would rely upon in providing credit. It was also observed that retention-of-title arrangements made practices, such as inventory financing, particularly difficult, since inventory financiers could not determine whether inventory was subject to such retention-of-title arrangements and, if so, what was the scope of such arrangements. In addition, it was said that general knowledge that there might be a retention of title was not sufficient and, in such situations, financiers would either not accept inventory as security or would accept it but add a premium to the cost of the transaction to cover for the risk that a retention-of-title holder might have priority.

71. Moreover, it was observed that, from a comparative law perspective, it was clear that a growing number of title transactions were used for security purposes and that any distinction with secured transactions would be artificial and could not be drawn. It was also said that the scope of the retention of title was also an important issue, namely whether it covered both the relevant asset and any proceeds from its sale. In that connection, it was pointed out that, even in countries that drew a distinction, retention of title was treated as a security right with respect to the proceeds of the asset that was subject to a retention of title.

72. As to pure title transactions, it was stated that they should not be subject to registration as they fell outside the scope of the secured transactions regime. In addition, it was observed that pure title transactions should not be covered by the registration system, since the purpose of a secured transactions regime could not be to establish a property registry for movables. In response, it was stated that a priority system would not be reliable unless it was comprehensive in covering all possible priority conflicts. It was noted that, in order to ensure that result, the United Nations Convention on the Assignment of Receivables in International Trade covered priority conflicts even between assignments within and outside the scope of the Convention. It was also observed that pure title arrangements should be covered by the registration systems so that an owner would have a right (not an obligation) to register and obtain priority.

73. With respect to registration of title transactions, it was stated that, if they were to be classified as secured transactions, in some countries, the following two approaches could be taken: the seller could be treated as an owner or as a

secured creditor (in the latter case, title would pass to the buyer). In either case, the seller would have to register, while the asset would be part of the insolvency estate and the seller would be given a heightened priority (even over creditors with an earlier in time filed security right; see A/CN.9/WG.VI/WP.2/Add.7, para. 20). In other countries, it was observed, a different approach was followed. If a title transaction served security purposes, the relevant asset would be part of the insolvency estate and the buyer as the owner could grant a second ranking security right. In situations where a pure title transaction was involved, the relevant asset would be separated from the insolvency estate (in liquidation proceedings). It was also stated that, from a legislative policy point of view, it would be preferable to convert title transactions to secured transactions, since, under such an approach, the rights of the buyer would be enhanced (the buyer would be treated as the owner) and the rights of the sellers could be protected through a heightened priority. In that connection, it was pointed out that the discussion of the rights of the buyer related also to a question discussed in a different context as to whether the grantor of a security right needed to have ownership or could have a lesser property right (see A/CN.9/WG.VI/I/CRP.1/Add.4, para. 12). In view of the importance of that issue, it was suggested that the relevant discussion should be placed in chapter *III*, dealing with the basic approaches to security.

C. Consensual vs. non-consensual security rights

74. In response to a question, it was noted that, while the focus of the Guide was on security rights created by agreement (consensual security rights), it was intended to cover all potential priority conflicts, including conflicts between consensual rights and rights created by operation of law (non-consensual rights). It was noted that the United Nations Convention on the Assignment of Receivables in International Trade had followed the same approach. It was, therefore, suggested that the definition of "security right" should be adjusted to reflect that understanding, which was also expressed at the UNCITRAL-CFA International Colloquium on Secured Transactions (see A/CN.9/WG.VI/WP.3, para. 8). In response to another question, it was stated that the term "non-consensual" was intended to cover prior preferential claims. In that connection, it was suggested that prior claims should be limited and transparent.

75. Differing views were expressed as to whether registration of a notice about a judgement by a creditor should give that creditor a right that was equivalent to a security right (see also A/CN.9/WG.VI/WP.2/Add.7, paras. 33-37). One view was that such an approach would encourage litigation or would even cause a "race to the court" by unsecured creditors and would result in the depletion of the debtor's estate to the detriment of unsecured creditors. Another view was that utilizing the registration system for collection of claims confirmed in court judgements would reduce litigation relating to execution of court judgements since, once the judgement was publicized, the debtor would pay to terminate the registration so as to be able to sell or encumber its assets.

D. Single registry vs. multiple registries

76. It was noted that the notion of a single registry referred to a single database and did not exclude multiple points from which to enter information into the

database. It was also stated that the draft Guide should emphasize that some civil law countries had long experience with asset-specific registries focusing on publicity rather than on fraudulent ante-dating. In addition, it was observed that decentralization in federal States often had to do with the federal structure of a State and might be avoided if an understanding was reached between the provinces and the federal State.

E. Notice vs. document filing

77. While support was expressed for notice filing, a number of concerns were also expressed. One concern was that it might not provide adequate information and require third parties to look outside the registry for the necessary information, which would put a burden on and risk misleading third parties. Another concern was that notice filing made it necessary for the secured creditor to summarize the security agreement in the notice, a process that was said to be prone to errors. It was observed that document filing would not raise these concerns. In response, it was pointed out that document filing raised concerns as to cost, confidentiality and error. It was also stated that a notice filing system did not present those disadvantages.

F. Timing of registration

78. It was suggested that the issue of the timing of registration in the case of insolvency should be discussed in chapter V, VII or X. It was also suggested that post-transaction registration establishing priority as of the time of the conclusion of the transaction rather than of registration should also be discussed (see exceptions to the first-to-file rule; see A/CN.9/WG.VI/WP.2/Add.7, para. 20).

G. Content of notice

79. It was suggested that the location of the assets should also be mentioned in the notice to be registered. That suggestion was objected to. It was stated that, in view of the nature of movable assets, it would be very difficult to immobilize them to a place specified in the notice. It was also observed that that matter was better left to the parties to address in their security agreement (A/CN.9/WG.VI/WP.2/Add.8). In response to a question as to whether the grantor should authorize or even sign the notice, it was noted that that matter was addressed in chapter VI (A/CN.9/WG.VI/WP.2/Add.6, paras. 15-17).

H. Coordination between general encumbrance registry and asset-specific title registries

80. It was stated that not all motor vehicle registries were title registries. It was also observed that there was no "one-size fits all" type of coordination between registries. Depending on the circumstances prevailing in a country, separate systems could be coordinated or joined in one system.

I. Registration and enforcement

81. It was stated that a distinction should be drawn between registration of notice of enforcement and registration of notice of a security right. In that connection, it was suggested that reference could be made to the OAS Model Law. It was also suggested that reference should be made to the consequences of failure to register in

the case of enforcement or insolvency proceedings, an issue that could be usefully expanded on in chapters VII (A/CN.9/WG.VI/WP.2/Add.7, paras. 43-45) and X (A/CN.9/WG.VI/WP.2/Add.10, para. 24) as well.

J. Debtor dispossession as a substitute for registration

82. Some doubt was expressed as to whether: debtor dispossession eliminated the problem of the appearance of false wealth; and the authority of the registry was reduced if, in cases where a creditor with a possessory security right relinquished possession and registered its right, the law permitted the effective date of security to relate back to the time of initial possession.

K. Third-party notice or control

83. It was noted that, in the case of a pledge of receivables, notification was considered in some legal systems as equivalent to possession. It was stated, however, that the discussion should be somehow adjusted to reflect that notification did not necessarily obligate an account debtor to pay the receivable owed. In that connection, it was observed that that obligation depended on the contract from which the receivable arose and, in particular, on whether the account debtor had any defences or rights of set-off, as well as on the payment instructions given to the debtor.

L. Third-party effects of unpublicized security rights

84. It was stated that the effects of publicity in the case of security rights in intangibles, such as receivables, needed to be further clarified.

M. Third-party effects of publicized security rights

85. It was observed that the notions of third-party effects and priority were distinct and should be further explained.

N. Summary and recommendations

86. The Working Group confirmed the universality of the principle of publicity, as reflected in paragraph 69 (A/CN.9/WG.VI/WP.2/Add.5), and decided to delete the second sentence of that paragraph.

87. After discussion, the Working Group requested the Secretariat to revise chapter V taking into account the views expressed and the suggestions made.

Chapter X. Insolvency

88. The Working Group agreed on the need to ensure, in cooperation with Working Group V (Insolvency Law), that issues relating to the treatment of security rights in insolvency proceedings would be addressed consistently with the conclusions of Working Group V on the interesection of the work of Working Group V and Working Group VI (see A/CN.9/511, paras. 126-127).

89. Various suggestions were made, including the suggestions to: refer to realization of value, rather than to enforcement as a common objective of secured credit and insolvency law; refer to stays issued at the discretion of the relevant

court; ensure the value of the security; consider whether, subject to the public policy of the forum with respect to the ranking of privileged claims and to the avoidance of fraudulent or preferential transactions, the conflict-of-laws rules applicable outside insolvency should also be applicable in an insolvency proceeding; refer to the possibility that, if in a liquidation proceeding the encumbered assets had not been sold within a reasonable period of time, the court could turn them over to the secured creditor, provided that there was a reasonable indication that the secured creditor could sell them more easily and at a better price; recognize that priviliged claims may be asserted against the encumbered assets but recommend that such claims should be limited, in number and amount, and be transparent; elaborate in the draft Guide on post-commencement financing and on the treatment of security rights in reorganization proceedings.

90. There was support in the Working Group for those suggestions. It was agreed that they should be brought to the attention of and addressed in cooperation with Working Group V.

IV. Future work

91. The Working Group noted that its second session was scheduled to take place in Vienna from 16 to 20 December 2002 and its third session was scheduled to take place in New York from 3 to 7 March 2003. It was noted that those dates were subject to the approval of the Commission at its upcoming thirty-fifth session to be held in New York from 17 to 28 June 2002.

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Draft Model Law on International Commercial Conciliation

Compilation of comments by Governments and international organizations

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Introduction

1. At its thirty-second session, in 1999, the Commission had before it a note entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.[1]

2. The Commission entrusted the work to one of its working groups, which it named the Working Group II (Arbitration and Conciliation) (hereinafter referred to as "the Working Group"), and decided that the priority items for the Working Group should be conciliation,[2] requirement of written form for the arbitration agreement,[3] enforceability of interim measures of protection[4] and possible enforceability of an award that had been set aside in the State of origin.[5]

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter referred to as "the New York Convention") (A/CN.9/468, para. 109 (k)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (g)); freedom of parties to be represented in arbitral proceedings by persons of their choice (para. 108 (c)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the New York Convention (para. 109 (j)); and the power by the arbitral tribunal to award interest (para. 107 (j)). It was noted with approval that, with respect to "online" arbitrations (i.e. arbitrations in which significant parts or even all of arbitral proceedings were conducted by using electronic means of communication) (para. 113), the Working Group would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (para. 107 (m)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.[6]

4. At its thirty-fourth session, in 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished so far regarding the three main issues

under discussion, namely, the requirement of the written form for the arbitration agreement, the issues of interim measures of protection and the preparation of a model law on conciliation.

5. With regard to conciliation, the Commission noted that the Working Group had considered articles 1-16 of the draft model legislative provisions (A/CN.9/WG.II/WP.113/Add.1). It was generally felt that work on those draft model legislative provisions could be expected to be completed by the Working Group at its next session. The Commission requested the Working Group to proceed with the examination of those provisions on a priority basis, with a view to the instrument being presented in the form of a draft model law for review and adoption by the Commission at its thirty-fifth session, in 2002.[7]

6. At its thirty-fifth session, held in vienna in November 2001, the Working Group discussed draft model legislative provisions on conciliation on the basis of the documents prepared by the Secretariat (A/CN.9/WG.II/WP.115 and A/CN.9/WG.II/WP.116). The deliberations and conclusions of the Working Group with respect to that item are reflected in document A/CN.9/506. Having completed its consideration of the substance of the provisions of the draft model legislative provisions on international commercial conciliation, the Working Group requested the Secretariat to establish a drafting group to review the entire text with a view to ensuring consistency between the various draft articles in the various language versions. The final version of the draft provisions as approved by the Working Group is contained in the annex to document A/CN.9/506, in the form of a draft model law on international commercial conciliation. The Secretariat was requested to revise the text of the draft guide to enactment and use of the model law, based on the deliberations in the Working Group. It was noted that the draft model law, together with the draft guide to enactment and use, would be circulated to member States and observers for comment, and presented to the Commission for review and adoption at its thirty-fifth session, to be held in New York from 17 to 28 June 2002 (A/CN.9/506, para. 13.

8. In preparation for the thirty-fifth session of the Commission, the text of the draft model law as approved by the Working Group was circulated to all governments and to interested international organizations for comment. The comments received as of 12 April 2002 from five governments and one non-governmental organization are reproduced below in the form in which they were communicated to the Secretariat.

Compilation of comments

A. States

Belarus

[Original: Russian]

1. In article 1, paragraph 4 (b), after the words "If a party does not have a place of business, reference is to be made to the party's habitual residence" add "(location)". Paragraph 4 (b) would then read as follows:

"(b) If a party does not have a place of business, reference is to be made to the party's habitual residence (location)."

2. Add the following article to the draft UNCITRAL Model Law on International Commercial Conciliation:

"Conciliation shall be deemed to have been attained if the claimant has reached an agreement with the respondent (renounced the claim), the respondent has reached an agreement with the claimant (acknowledged the claim) or if the parties have reached an agreement as a result of mutual concessions. Mutual concessions with respect to the object of the dispute shall be possible if they do not contradict the imperative norms of the law and the nature of the contentious legal relationship. Mutual concessions shall also be permitted with respect to the division of the costs of the case and the time limits and procedure for the performance by the parties of the obligations that they have assumed."

Ecuador

[Original: Spanish]

1. Article X, Suspension of limitation period, which appears in document A/CN.9/506 as footnote 3 to Article 4 of the Draft Model Law and is foreseen as being optional, should be in the main part of the Model Law. Without a provision having that content, in general, for those who do not wish to adopt the aforementioned optional provision there would result an interruption of the limitation period, which, at the end of an unsuccessful attempt at conciliation, would have to start running again from day one, which would not happen if suspension was specified.

2. In Article 8 it would be better to delete the words "or a member of the panel", since they open up the possibility of one of the conciliators (where there are more than one) meeting or communicating on his/her own with the parties together or with each of them separately. Such authorization through the Model Law would not contribute to the transparency necessary as evidence of the impartiality of the conciliator, even though he/she has been designated by one of the parties.

Consequently, Ecuador considers that the original version of Article 9, the one examined by the Working Group during its 35th session, should be retained.

France

[Original: French]

Article 1. Scope of application and definitions

1. Paragraph 3

France agrees with the criterion adopted for the scope of application of the model law: by referring to intrinsic internationality, independent of any spatial criterion, it has the great merit of simplicity.

2. Paragraph 8

It is the understanding of France that the draft law, at the disposal of the parties wishing to conciliate, does not apply to conciliation at the initiative of a court. It would not, therefore, necessarily be redundant to specify such an exclusion explicitly.

Article 3. Variation by agreement

3. This article, which specifies which of the model law's provisions—of a residual nature—may not be excluded, should also cite **article 15. Enforceability of settlement agreement**. The adopted text should therefore include this additional reference.

Article 4. Commencement of conciliation proceedings

4. Including an article X as an optional article has the merit of highlighting the problematic nature of the question of the limitation period.

Article 14. Resort to arbitral or judicial proceedings

5. Paragraph 1

In the interests of giving effect to a conciliation settlement when there is an express conciliation clause, France proposes that the paragraph read as follows:

> "*Where the parties have agreed to conciliate, such an undertaking shall be given effect by the arbitral tribunal or the court until evidence is furnished that the procedure was undertaken unsuccessfully*."

Article 15. Enforceability of settlement agreement

6. As things stand, we support this provision. Indeed, France would be opposed to having an arbitral proceeding grafted onto the settlement agreement. Converting a

conciliation settlement into an arbitral award is not at all acceptable since it would amount to attaching the same status to an act between two private persons as to a court decision. There are two possibilities: either the conciliation settlement is turned into a "real" arbitral award, but here one would have to qualify the enforceability of an award as being "in due form", with the proceedings becoming far more cumbersome as a result and more expensive for the parties (thus running counter, of course, to the whole spirit of conciliation); or else there could be a kind of quasi-automatic equating of the conciliation settlement to an arbitral award, which would entail some degree of exposure to abuse since the contract (conciliation settlement) would not be subject to scrutiny by a court of the country in which the settlement is invoked except in a limited range of cases (cf. for France, article 1502 NCPC (New Code of Civil Procedure)).

In order to meet this concern, France proposes the following wording:

"*The authority of* res judicata *and/or the enforceability of such agreement shall, as appropriate, be recognized or granted by the law or the competent authority of the country in which the agreement is invoked.*"

Hungary

[Original: English]

1.) **Article 1, paragraph (6)** the parties are free to agree to exclude the applicability of the Model Law. In view of the Hungarian Party there is a need a legally binding minimum law with respect to the conciliation proceedings, which are able to ensure the equality of the parties. A permissive legislation would attenuate this precondition. If the paragraph (6) remains unchanged, an agreement has to be reached in order to ensure that the parties are permitted to exclude the applicability of the whole Law or only a certain part (some provisions) of it. The latter solution is preferable.

2.) **Article 14, paragraph (1)**

Taking into consideration the current Hungarian law on judicial procedure it is difficult to fulfil the provisions of this paragraph. Those provisions can be performed only by voluntary acceptance of the parties.

3.) **Article 15**

According to the Hungarian Act LIII of 1994 the provisions of Article 15 of the Model Law can not be applied in Hungary. The chapter II, Section 10 of that Act lays down the rule that the judicial execution shall be ordered by the issue of an executable document. Executable documents are: (i) certificate of execution issued by a court, (ii) document with a writ of implementation issued by a court, (iii) a judicial order or restraint of execution, or order of transfer, furthermore, a decree of direct court notice. The Act narrows down the number of enforceable documents. A direct enforcement of the settlement agreement can not be favoured, because it could have effects similar to the ones when declaring the direct enforcement of a contract.

A solution could be found through the conciliation-mediation proceedings which would be carried out under the auspices of a permanent court of arbitration. The Rules of procedure of the Hungarian Arbitration Court (attached to the Hungarian Chamber of Commerce and Industry) contains the following provisions: "At the joint request of the Parties the President of the Arbitration Court shall appoint the conciliator-mediator as sole arbitrator. The sole arbitrator shall render an award containing the agreement reached and signes by the parties." (52§(2) Rules of Proceedings of the Court of Arbitration attached to the Hungarian Chamber of Commerce and Industry, effective as of September 1. 2001).

4.) Furthermore it is to be pointed out that the conversion of a settlement agreement into an arbitration award could also be reached outside of the framework of a permanent arbitration proceedings. After having reached an agreement in the course of the conciliation proceedings the parties could at the same time establish an ad hoc arbitration and appoint the conciliator as a sole arbitrator. In that case the parties are able to transform their settlement agreement into an arbitral award which can be enforced without any difficulties.

Turkey

[Original: English]

- In the 5th article of the Draft, titled "The Number of Mediators", no articles are included relating to "Joint action" of the mediation committee at the construction stage of agreement between the parties in order to ensure harmony during the mediation process, and it is considered that this will create a loophole with regard to the field of application of the law.

- It is suggested that the "obligation to keep the information relating to the mediation process confidential" included in article 10, be broadened so as to ensure that such confidentiality covers the protection of images and names and also that the trade secrets or other information are kept between the parties, in a way to include the negotiation agreement as well.

- With regard to paragraph 3 of article 11, which covers the disclosure of information and documents submitted during the mediation process, it is suggested that a phrase be inserted to this paragraph stating that the information and documents submitted in the mediation process may also be disclosed upon "approval of the parties" as well as by the order of law and in line with the application or execution of the negotiation agreement.

- In order to prevent the use of information and documents received from the parties by the mediator when fulfilling his/her duty, article 13 of the Draft stipulates that a mediator cannot act as an arbitrator in the arbitration process following the mediation process. It is suggested that the tribunal process following the mediation process also be added to this phrase along with a statement indicating that the negotiator who is banned from disclosing the information he/she acquired as per

article 11, cannot act as arbitrator or be a referee, representative or attorney to any of the parties.

- It is suggested that an article on mediation expenses be added to the Draft.

- The Draft does not include any arrangements as regards the course of the mediation process or re-election procedures in case of decease or resignation of the mediator.

B. Intergovernmental organizations

Permanent Court of Arbitration

[Original: English]

This comment deals under A. with art. 4 of the final draft of the Working Group on Arbitration (A/CN.9/506). In addition, under B. some comments are made on art. 1 in relation to the comments made on art. 4 under A.

A. Article 4

1. This article reads (emphasis added):

Article 4. Commencement of conciliation proceedings

(1) Unless otherwise agreed by the parties, the conciliation proceedings in respect of a particular dispute that has arisen commence on the day on which the parties to the dispute agree to engage in conciliation proceedings.
(2) If a party that invited another party to conciliate does not receive an acceptance of the invitation within thirty days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate. (emphasis added)

It is submitted that art. 4(2) should not apply when, as normally is the case, conciliation proceedings commence on the basis of a prior agreement of the parties to conciliate (e.g., a conciliation clause in a commercial contract). The requirement of accepting the invitation to conciliate should only apply when parties have not already agreed to enter into conciliation proceedings in order to settle their dispute. In this case, the agreement of the other party is indeed required. Unlike conciliation on the basis of a prior agreement to conciliate, this rarely occurs. Inviting a party to conciliate when a dispute has arisen may be regarded by the other party as a sign of weakness.

This obstacle does not exist when parties have concluded a prior agreement to conciliate. If the parties previously agreed to resort to conciliation, no subsequent agreement to conciliate should be needed when a dispute arises. Allowing for the possibility to reject engaging in conciliation proceedings would deprive the original

agreement of any meaning. The original agreement should oblige the parties to appoint a conciliator or panel of conciliators and to have at least one meeting with the conciliator or panel of conciliators.

2. Modern Conciliation Rules provide for such consequences of an agreement to conciliate. For example, the WIPO Mediation Rules (World Intellectual Property Organization) state in art. 18:

"The mediation shall be terminated

...

iii. by a written declaration of a party at any time after attending the first meeting of the parties with the mediator...".

Similarly the Mediation Procedure Rules of the C.P.R. (Center for Public Resources, New York) Institute for Dispute Resolution state in art. 3 under (b) that a party may withdraw only

> "after attending the first session".

Also the "Guide to ICC ADR Rules" which accompanies the new ICC ADR Rules (2001) states on page 20 with respect to art. 2.A: "Where there is an agreement to refer to the Rules":

> "... parties may not withdraw from the proceedings prior to a first discussion with the Neutral".

3. Not only art. 4 but also art. 12 and art. 6 of the final draft of the Working Group will need modification if the examples mentioned under 2. are followed.

(a) Article 12

Article 12 deals with "Termination of Conciliation". According to this article: "The conciliation proceedings are terminated" on the grounds enumerated under (a)-(d). Ground (d) deals with withdrawal from the conciliation proceedings by one party "by a written declaration of a party".

The one-side withdrawal should be maintained, but should be limited to "a written declaration by one party to the other party and the conciliator or the panel of conciliators after the first meeting with them".

(b) Article 6

Article 6 deals with the "Appointment of Conciliators". This article does not guarantee that a conciliator will be appointed in all circumstances. Paragraph 4 of the article only provides for assistance by an "appropriate institute or person" when parties are looking for a suitable person to be appointed by them. However, this institute or person should also act as Appointing Authority when parties fail to agree on the appointment of the conciliator.

In order to cover the failure of the parties to appoint a conciliator, art. 6 should introduce the same fallback provision as in the UNCITRAL Arbitration Rules: appointment by an institute or person acting as Appointing Authority (A.A.). This A.A. may be agreed upon by

the parties or, if not agreed by the parties, shall be designated by the Secretary General of the Permanent Court of Arbitration.

B. Comments on Article 1 in relation to the comments made under A.

1. Article 1, paragraph 8

Article 1 on the "Scope of Application" excludes in para. 8 the application of the Model Law "when a judge or an arbitrator attempts to facilitate a settlement".

This provision acknowledges that an arbitrator may act as conciliator in order to facilitate attempts to reach a settlement. However, an arbitrator has been appointed to decide the dispute. Acting as conciliator will put the arbitrator in a delicate position if his attempt to reach a settlement fails. For example, what about the confidentiality of information received from the parties during these attempts? What about the confidentiality of acknowledgments made by parties in the course of the conciliation if the arbitral proceedings continue because no settlement has been reached? There also is the risk that the arbitrator might be challenged if, during the conciliation intermezzo, the arbitrator in the view of one of the parties, may not have acted impartially. It, therefore, is submitted to delete "or as arbitrator" in para. 8 of art. 1.

The Model Law excludes a conciliator from acting as arbitrator unless otherwise agreed by the parties (art. 13). A similar exclusion should be made for an arbitrator acting temporarily as conciliator. It, therefore, is submitted to exclude in an additional article the arbitrator from acting as conciliator, unless otherwise agreed by the parties.

In arbitration practice it does indeed occur that parties request the arbitrators, who are already well-informed about the case, to assist them in attempts to conciliate. Arbitrators should refrain from accepting such an invitation. Instead, the arbitrators could suspend the arbitral proceedings for a short period and recommend the parties to resort to conciliation under well-drafted Conciliation Rules with the assistance of a third party, well trained in conciliation.

In view of the authority of an arbitral tribunal, the parties may be well inclined to accept this recommendation. If the attempt to reach a settlement were to be successful, the arbitral tribunal could, on request of the parties, incorporate the settlement in an award on agreed terms. See further my *Quo Vadis Arbitration?* (1999) 372-374.

2. Article 1, paragraph 7

Paragraph 7 of art. 1 makes the Model Law applicable in several cases "subject to the exclusion as provided in paragraph (8)". The Model Law applies first of all to a conciliation agreement between the parties "whether reached before or after a dispute has arisen". The conciliation agreement has been discussed above, under A. According to para. 7, the Model Law applies as well:

(a) In case an obligation to conciliate is established by law

This makes the Model Law, when transformed into national law, applicable to an obligation to conciliate, established in another national law. The current version of the draft, requiring a subsequent agreement of the parties to engage in conciliation proceedings when a dispute has arisen, should not apply in case the law obliges to conciliate.

(b) In case a direction or suggestion of a court, arbitral tribunal or competent government entity has been made

The court

When conciliation has been directed by a court, this should not be frustrated by a party rejecting to engage in conciliation proceedings.

The arbitral tribunal

The same applies when the arbitral tribunal may have directed or suggested that the parties should enter into settlement negotiations.

A competent governmental entity

Also in this case a direction by this entity should not be frustrated by a party rejecting to engage in conciliation proceedings.

Ad (a) and (b)

In all these cases conciliation will take place without a previous agreement of the parties to conciliate. Moreover, in all these cases a conciliator or conciliators should be appointed and a first meeting with the conciliator or conciliators has to take place before a party can withdraw from the conciliation proceedings.

Under the Model Law the same conciliation regime should apply to the situation described under A. as well as B.

Conclusion

The draft Model Law on International Commercial Arbitration, as submitted to the Commission for approval, should be modified along the lines as suggested under A. When this is done, the same regime will apply to conciliation under a previous agreement to conciliate and to conciliation taking place in the cases mentioned under B.

Notes

[1] *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 337.

[2] Ibid., paras. 340-343.

[3] Ibid., paras. 344-350.

[4] Ibid., paras. 371-373.

[5] Ibid., paras. 374 and 375.

[6] Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 396.

[7] Ibid., *Fifty-sixth Session, Supplement No. 17* (A/56/17), paras. 309-315.

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Draft Model Law on International Commercial Conciliation

Compilation of comments by Governments and international organizations

Addendum

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* The date of submission of the document results from the dates at which comments were received by the Secretariat.

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Introduction

1. In preparation for the thirty-fifth session of the Commission, the text of the UNCITRAL draft model law on international commercial conciliation was circulated to all governments and to interested international organizations for comment. The text of the draft model law was approved by UNCITRAL Working Group II (Arbitration and Conciliation) at its thirty-fifth session and annexed to the report of that session (A/CN.9/506). Additional comments received as of 30 April 2002 from one government are reproduced below in the form in which they were communicated to the Secretariat.

Compilation of comments

A. States

Philippines

[Original: English]

A. Article 1. Scope of Application and Definitions

"(1) This law applies to international commercial conciliation."

The definition of the term "commercial" should be included in the body of the draft UNCITRAL Law on International Commercial Conciliation (hereafter referred to as the "Draft Law"). The inclusion of such definition is necessary to determine the scope and application of the proposed Draft Law and at the same time determine whether the transaction is definitely commercial or not.

"(2) For the purpose of this Law, "conciliation" means a process, whether referred to by the expression conciliation, mediation or an expression of a similar import, whereby parties request a third person, or a panel of persons, to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contractual or other legal relationship. The conciliator or panel of conciliators does not have the authority to impose upon the parties a solution to the dispute."

Although it is agreeable that the conciliator or the panel of conciliators is not given the authority to impose upon the parties a solution to the dispute, it is however desirable that the conciliator or panel of conciliators be given at least the expressed authority to make non-binding proposals for possible solution in the settlement of the dispute, subject to the agreement of the parties. This will expedite the settlement of dispute.

"(3) A conciliation is international if:

(a) The parties to an agreement to conciliate have, at the time of the conclusion of that agreement, their places of business in different States; or

(b) The state in which the parties have their places of business is different from either;

(i) The State in which a substantial part of the obligations of the commercial relationship is to be performed; or
(ii) The State with which the subject matter of the dispute is most closely connected."

The term "substantial part of the obligations" and "most closely connected" should be elaborated and explained further. It may happen that in a single contract, a series of transactions are required to be performed, each act

constituting an integral part of the contract or substantial part of the performance of the obligation.

"(8) This Law does not apply to

(a) Cases where a judge or an arbitrator, in the course of a court or arbitral proceeding, attempts to facilitate a settlement; and
(b) [...]"

It is suggested that clarification should be made whether the provision applies to cases where the conciliation proceeding has already been commenced and thereafter a party to the dispute filed a case in court to preserve his or her right. It is uncertain furthermore whether the court can totally disregard the findings in the conciliation proceedings and make a determination on its own with regard to the facts necessary for the settlement of the dispute.

B. Article 6. Appointment of Conciliators

"(6) When a person is approached in connection with his or her possible appointment as a conciliator, he or she shall disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence. A conciliator, from the time of his or her appointment and throughout the conciliation proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him or her."

The last sentence of the above provision could lead to abuse and should be amended to make it still necessary for the conciliator appointed to personally inform the parties on the circumstances that might affect his or her impartiality or independence as a conciliator to the dispute, when such facts or circumstances are already known to the parties.

In addition, Article 6 should provide provisions qualification, regarding the qualification replacement and incapacity of the conciliator.

C. Article 8. Communication Between Conciliator and Parties

"Unless otherwise agreed by parties, the conciliator, the panel of conciliators or a member of the panel may meet or communicate with the parties together or with each of them separately."

It must be noted that under the UNCITRAL Conciliation rules, Article 9 (2) states that:

"Unless the parties agreed upon the place where the meeting with the conciliator are to be held, such place will be determined by the conciliator, after consultation with the parties, having regard to the circumstances of the conciliation proceedings."

D. Article 11. Admissibility of Evidence in Other Proceedings

"(1) Unless otherwise agreed by the parties, a party that participated in the conciliation proceedings or a third person, including a conciliator, shall not in arbitral, judicial, or similar proceedings rely on, introduce as evidence or give testimony or evidence regarding, any of the following:

(a) An invitation by a party to engage in conciliation proceedings or the fact that a party was willing to participate in conciliation proceedings;
(b) Views expressed or suggestions made by a party to the conciliation in respect of a possible settlement of the dispute;
(c) Statements or admissions made by a party in the course of the conciliation proceedings;
(d) Proposals made by the conciliator;
(e) The fact that party to the conciliator had indicated its willingness to accept a proposal for the settlement made by the conciliator;
(f) A document prepared solely for purposes of the conciliation proceedings."

It is suggested that the Draft Law should state that the executed and signed Conciliation agreement be presented as part of proof regarding the conciliation proceedings itself. The conciliation agreement, it must be noted, constitute a binding contract between the parties to the settled dispute.

E. Article 15. Enforceability of Settlement Agreement

"If the parties reach and sign an agreement settling a dispute, that settlement agreement is binding and enforceable... [the enacting State inserts a description of the method of enforcing settlement agreements or refers to provisions governing such enforcement]."

It is suggested that the term "final" be inserted before the word "binding" to give emphasis to the effect of the settlement agreement. The insertion of the word "final" in the provision will serve as a caveat that the settlement agreement cannot be disregarded or changed arbitrarily.

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Draft Model Law on International Commercial Conciliation

Compilation of comments by Governments and international organizations

Addendum

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Introduction

1. In preparation for the thirty-fifth session of the Commission, the text of the UNCITRAL draft model law on international commercial conciliation was circulated to all Governments and to interested international organizations for comment. The text of the draft model law was approved by UNCITRAL Working Group II (Arbitration and Conciliation) at its thirty-fifth session and annexed to the report of that session (A/CN.9/506). Additional comments received after the deadline of 15 March 2002 from one Government are reproduced below in the form in which they were communicated to the Secretariat.

Compilation of comments

A. States

Morocco

[Original: French]

1. The draft constitutes a legal platform for helping countries to introduce amendments as they adapt to current developments.

2. It should be noted in this regard that the provisions in the draft give States that wish to incorporate this law into their domestic law the possibility of adapting and amending it in accordance with their own particular situation.

3. The following questions arise in connection with specific points:

(a) In order to determine clearly the enforceability of conciliation proceedings, the question arises whether conciliation is mandatory or optional;

(b) May the internal justice system adopt documents, statements and reports submitted during conciliation proceedings?

4. The title of article 1 should be amended to read: "Definitions and scope of application".

5. The definitions of the three words "international", "commercial" and "conciliation" should be incorporated into article 1.

6. The issue of the enforceability of the agreement concluded between the parties during the conciliation proceedings raises the question of procedures for enforcement.

7. The competent Moroccan authorities consider the draft a useful contribution to efforts to establish an appropriate legislative framework for the settlement of commercial disputes, i.e. a framework able to accommodate simple, quick, extrajudicial proceedings which are better suited to the nature of such disputes.